



# **Department of Veterans Affairs Office of Inspector General**

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## **REPORT OF THE AUDIT OF THE DEPARTMENT OF VETERANS AFFAIRS CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEARS 2004 AND 2003**

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Report No. 04-00986-14

VA Office of Inspector General  
Washington, DC 20420

November 15, 2004

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FINAL DISTRIBUTION



**DEPARTMENT OF VETERANS AFFAIRS**  
**Office of Inspector General**  
**Washington DC 20420**

**Memorandum to the Secretary**

**Report of Audit of the Department of Veterans Affairs Consolidated  
Financial Statements for Fiscal Years 2004 and 2003**

1. Attached is the Report of Audit of the Department of Veterans Affairs (VA) Consolidated Financial Statements (CFS) for Fiscal Years (FY) 2004 and 2003, as required by the Chief Financial Officers Act of 1990. The Office of Inspector General contracted with the independent public accounting firm, Deloitte & Touche LLP, to perform the audit of VA's FY 2004 CFS.
2. The independent auditors' report by Deloitte & Touche LLP provides an unqualified opinion on VA's FYs 2004 and 2003 CFS. The report on internal control identifies four reportable conditions, of which two are material weaknesses. The two material weaknesses are (i) information technology security controls and (ii) integrated financial management system. The two reportable conditions are (i) operational oversight and (ii) judgments and claims. During FY 2004, VA management took corrective action to eliminate the medical malpractice and claims data reportable condition reported in the FY 2003 audit report.
3. The report on compliance with laws and regulations continues to show that VA is not in substantial compliance with the financial management system requirements of the Federal Financial Management Improvement Act of 1996. The internal control issues concerning an integrated financial system and information technology security controls indicate noncompliance with the requirements of Office of Management and Budget (OMB) Circular A-127, "Financial Management Systems," which incorporates by reference OMB Circulars A-123, "Management Accountability and Control," and A-130, "Management of Federal Information Resources."
4. The auditors' unqualified opinion was achieved through the extensive efforts of program and financial management staff, as well as the auditors, to overcome material weaknesses in internal control to produce auditable information after the fiscal year-end. Although these efforts resulted in materially correct annual financial statements, reliable information was not readily available during the year. The risk of materially misstating financial information remains high using the existing financial management systems.

5. The independent auditors will follow up on these internal control findings and evaluate the adequacy of corrective actions taken during the audit of the VA's FY 2005 CFS.



MICHAEL L. STALEY  
Assistant Inspector General for Auditing

Attachment

## **SECTION I**

### **INDEPENDENT AUDITORS' REPORT**



Deloitte & Touche LLP  
555 12<sup>th</sup> Street, N.W.  
Suite 500  
Washington, DC 20004-1207

Tel: 202-879-5600  
Fax: 202-879-5309  
www.us.deloitte.com

## INDEPENDENT AUDITORS' REPORT

Secretary  
Department of Veterans Affairs

We have audited the accompanying consolidated balance sheets of the Department of Veterans Affairs (VA) as of September 30, 2004 and 2003, and the related consolidated statements of net cost, changes in net position, financing and the combined statements of budgetary resources for the years then ended which collectively comprise VA's basic financial statements. These financial statements are the responsibility of VA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the requirements of Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and the OMB Bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of VA as of September 30, 2004 and 2003, and the respective net costs, changes in net position, financing and budgetary resources thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 4, 2004, on our consideration of VA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A stylized, handwritten-style signature of "Deloitte &amp; Touche LLP" in black ink.

November 4, 2004

A member firm of  
**Deloitte Touche Tohmatsu**

## **SECTION II**

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS  
BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH  
*GOVERNMENT AUDITING STANDARDS***



**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Secretary  
Department of Veterans Affairs

We have audited the basic financial statements of the Department of Veterans Affairs (VA), as of and for the year ended September 30, 2004, and have issued our report thereon dated November 4, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the requirements of the Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit, we considered VA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect VA's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

We identified the following matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions that we identified in our prior year report dated November 11, 2003 are identified as repeat conditions.

Four reportable conditions are described in the following paragraphs and include significant departures from certain requirements of OMB Circular A-127, "Financial Management Systems," which incorporates by reference Circulars A-123, "Management Accountability and Control," and A-130, "Management of Federal Information Resources," among other requirements. We believe that the two reportable conditions identified

as “Information Technology (IT) Security Controls” and “Integrated Financial Management System” are also material weaknesses.

## **INFORMATION TECHNOLOGY**

### **Information Technology (IT) Security Controls – Material Weakness (Repeat Condition)**

VA continued to make organizational changes in the IT area during fiscal year (FY) 2004 that facilitated IT security controls improvements through centralization of certain information technology controls initiatives. Many application program offices have also taken corrective actions to remediate material weaknesses reported in our prior year report. However, VA’s program and financial data continue to be at risk due to serious weaknesses related to: 1) inadequate implementation and enforcement of controls and oversight over access to information systems; 2) improper segregation of key duties and responsibilities of employees; and 3) underdeveloped contingency planning. These weaknesses placed sensitive information, including financial data and sensitive veteran medical and benefit information, at risk of inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction, possibly occurring without detection.

Our testing of key controls over the general computer systems at the VA’s primary data centers and 14 medical facilities, the Veterans Health Information Systems and Technology Architecture (VISTA) application, and our external and internal network vulnerability assessment of the VA’s network infrastructure, identified the following control weaknesses:

#### *Access Control*

- For general computer systems including network and operating systems, the control weaknesses included inconsistent implementation of internal wide area network access authentication mechanisms and administration of user access, inappropriate access privileges due to non-restrictive system access profiles for internal operations and programming staff, and inconsistent monitoring and review of user access.
- The internal vulnerability assessment disclosed vulnerabilities related to weak operating systems configurations and passwords on administrative level accounts, a lack of robust intrusion detection alerts, and coordination and communication between security functions.

#### *Segregation of Duties*

- In the Integrated Funds Distribution, Control Point Activity, Accounting and Procurement (IFCAP) and Automated Engineering Management System/Medical Equipment Reporting System (AEMS/MERS) applications, we identified improper design of system controls to support segregation of duties and responsibilities of employees who had super user rights.

#### *Service Continuity*

- A business continuity plan at the VA level has not been fully developed to provide overall guidance, direction and coordination for IT service continuity. The “Bull” operating system, supporting VBA’s applications such as compensation, pension and education programs and data, has not been tested for the service continuity purpose because the backup hardware does not have adequate memory and processing capacity. Certain legacy loan guaranty system components, such as the Property Management System

and Guaranteed and Insured Loan System, are not likely to be recovered within the specified timeframe due to inadequate technical documentation on these applications. In addition, testing of the Continuity of Operations Plan at certain medical facilities has not been consistently scheduled and performed.

VA's success in improving information security is dependent on VA's continued effort in comprehensively addressing these weaknesses at an enterprise level, including continuing its high level of coordination and obtaining adequate resources to implement the plan.

### **Recommendations:**

The VA Chief Information Officer (CIO) should:

1. Apply appropriate resources and establish a clear chain of command and accountability structure in implementing and enforcing information technology internal controls in order to implement planned corrective actions and remediate identified deficiencies within a reasonable timeframe. Perform proactive oversight of compliance with established IT internal control policies and procedures.
2. Improve access control policies and procedures to provide actionable steps for configuring security settings on operating systems, improving administration of user access, and intrusion detection alerting.
3. Evaluate user functional access needs and privileges to ensure proper segregation of duties within financial applications such as the IFCAP and AEMS/MERS. Assign, communicate, and coordinate responsibility for enforcing and monitoring such controls in a consistent fashion throughout VA.
4. Develop a business continuity plan at the VA level that will facilitate effective communication and implementation of overall guidance and standards, and provide coordination of VA's business continuity effort. Schedule and test IT disaster recovery plans to ensure continuity of operations in the event of a disruption of service.

## **OPERATIONS**

### **Integrated Financial Management System – Material Weakness (Repeat Condition)**

As defined in OMB Circular A-127, "a financial management system encompasses automated and manual processes, procedures, controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions." Such financial management systems shall be designed to provide for an effective and efficient interrelationship between software, hardware, personnel, procedures, controls, and data contained within the systems.

With respect to system requirements in the area of financial reporting, OMB Circular A-127 provides that an agency's financial management system should generate reliable, timely, and consistent information necessary for meeting management's responsibilities, including the preparation of financial statements. Within OMB Circular A-123, the management control processes necessary to ensure that "reliable and timely information is obtained, maintained, reported and used for decision making" are set forth, including prompt and appropriate recording and classification.

During our audit of VA's consolidated financial statements, we noted continuing difficulties related to the preparation, processing, and analysis of financial information to support the efficient and effective preparation

of VA's consolidated financial statements. While significant efforts are made at the component and consolidated levels to assemble, compile, and review the necessary financial information for annual financial reporting requirements, in many cases, components of certain feeder systems and financial applications are not fully integrated with the core Financial Management System. As a result, significant manual work-arounds and out-of-date systems impede the process. For example, we noted that:

- Reconciliations of property records in the loan guaranty programs continue to identify significant differences from non interfaced systems;
- Within the compensation, pension and education programs, there are a number of programs that do not directly interface with the general ledger or they interface at various intervals. As a result, numerous adjusting entries resulting from timing differences are necessary to reconcile balances with the general ledger to ensure the amounts are properly stated; and
- In the life insurance programs, the lack of system interface with the VA's general ledger creates the need for a significant amount of adjusting entries. We observed that some journal entries were not posted to the general ledger nor were reconciling items identified and posted timely.

*Recommendation:*

5. The VA CIO and Chief Financial Officer (CFO) should develop and implement a fully integrated financial management system. The VA CFO should implement and enforce supplemental manual processes to meet appropriate control objectives until a fully integrated financial management system is implemented.

**Operational Oversight  
(Repeat Condition)**

With more than 150 medical centers nationwide, management oversight at the medical centers is essential to ensure compliance with Departmental established policies and procedures. To assess the effectiveness of internal controls at the medical center level, we conducted tests at 14 medical centers within 11 Veterans Integrated Service Networks (VISNs) to (1) determine whether staffs were aware of key internal controls, (2) review evidence to determine whether internal controls were functioning as intended and (3) assess the effectiveness of the internal controls.

During our testing, we continued to find a number of previously reported instances where key internal controls and reconciliation processes were not performed consistently or completely. The Veterans Health Administration (VHA), Office of the CFO, has implemented a monthly reconciliation monitoring process. VHA also conducted training designed specifically for medical center accountants and developed performance measures for the VISN's scorecard to monitor medical center progress in complying with certain Departmental policies and procedures. Although there has been improvement, our testing at the medical centers showed continued noncompliance with certain established policies and procedures. Among the control exceptions found at the medical centers were:

- Supervisory reviews of medical accounts receivable reconciliations were not completed in accordance with certain VA procedures;
- Completed construction or upgrade projects were not capitalized in a timely manner;

- Non-expendable equipment inventories were not completed or were not completed in accordance with certain VA policies and procedures;
- Accounts receivable collections were not properly completed or were not completed in a timely manner;
- Monitoring of accrued services payable transactions was not effectively performed;
- Estimated environmental clean-up costs were not reported in a timely manner; and
- Deferred maintenance costs were not recorded or were incorrectly recorded in the general ledger.

*Recommendations:*

6. The VHA CFO should continue monitoring monthly reconciliations at the medical centers, develop training programs in areas where noncompliance continues to exist, and use the VISN scorecards to measure compliance with VA policies and procedures to improve internal controls over financial reporting; and
7. Management at the medical centers should take action necessary to comply with VA policies and procedures.

**Judgments and Claims**

VA's Office of General Counsel (OGC) GCLAWS claims tracking system records medical malpractice claims and is used as an input to the model which estimates the value of future settlements pursuant to Statement of Federal Financial Accounting Standard Number 5, *Accounting for Liabilities of the Federal Government*. VA management was unable to explain differences between the amount of settled tort claims recorded in the GCLAWS system and the amount of paid claims recorded in the Judgment Fund maintained by the Department of the Treasury. The Judgment Fund is an appropriated government-wide fund from which settlement payments can be made for both tort and other claims and settlements against the VA based on the authorization of the OGC or the Department of Justice. As a result, the VA could not determine that it provided the appropriate information to the estimation model or that charges to the Judgment Fund were appropriate.

*Recommendation:*

8. The CFO should establish a process to regularly reconcile and investigate differences between the paid claim amounts recorded in GCLAWS and amounts paid from the Judgment Fund.

**Follow-up on Previous Report**

In our *Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance Based Upon the Audit Performed in Accordance with Government Auditing Standards* dated November 11, 2003, we reported four reportable conditions (with two material weaknesses) in the areas of (1) Information Technology (IT) Security Controls, (2) Integrated Financial Management System, (3) Operational Oversight and (4) Medical Malpractice Claims Data. In FY 2004, the material weaknesses repeated are items (1) and (2), and the repeat reportable condition is item (3). Item (4) has been corrected.

\* \* \* \* \*

With respect to the internal control related to performance measures reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02, as amended. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not provide an opinion on such controls.

In addition, we considered VA's internal control over Supplementary Information by obtaining an understanding of VA's internal control, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 01-02 as amended. Our procedures were not designed to provide assurance on these internal controls. Accordingly, we do not provide an opinion on such controls.

## **COMPLIANCE AND OTHER MATTERS**

As part of obtaining reasonable assurance about whether VA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, and are described below.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U. S. Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance and evaluative criteria issued by OMB in Circular A-127.

The material weaknesses in internal control over financial reporting discussed above and identified as "Information Technology (IT) Security Controls" and "Integrated Financial Management System" indicate that VA is not in full compliance with the requirements of OMB Circulars A-123, A-127, and A-130. As discussed above, we found material weaknesses in (1) the effectiveness of the information technology controls; and (2) the design and operation of internal controls over financial reporting, particularly with effectiveness of the control monitoring and reconciliation processes in support of the preparation of the Department's consolidated financial statements.

We believe these material weaknesses, in the aggregate, result in departures from certain of the requirements of OMB Circulars A-123, A-127 and A-130, and are, therefore, instances of substantial noncompliance with the Federal financial management systems requirements under FFMIA.

In addition, we noted other matters involving the internal control and compliance over financial reporting that we have reported to the VA, in a separate letter dated November 4, 2004.

## **DISTRIBUTION**

This report is intended solely for the information and use of the VA Office of Inspector General, the management of the VA, the Office of Management and Budget, the U.S. Government Accountability Office, Office of the President and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte & Touche LLP*

November 4, 2004

### **SECTION III**

**ACTING ASSISTANT SECRETARY FOR MANAGEMENT'S COMMENTS**



# Memorandum

## Department of Veterans Affairs

NOV 10 2004

Date:

From: Acting Assistant Secretary for Management (004)

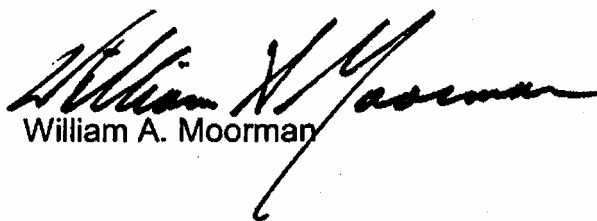
Subj: Report of Audit of VA's Consolidated Financial Statements for FY 2004 and 2003

To: Assistant Inspector General for Auditing (52)

1. The Office of Management is pleased to receive an unqualified opinion in the Report of Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Years 2004 and 2003. We are especially proud in meeting the FY 2004 timeframe requirements established by the Office of Management and Budget. Please extend to your staff and the staff of Deloitte & Touche, LLP, my appreciation for their detailed planning, hard work and cooperation during this year's audit.

2. We will share the results of the audit, as well as the findings on internal controls over financial reporting and regulatory compliance, with senior officials in the Administrations and with other VA staff and program managers. We will continue to provide you with updates on our progress in implementing management plans to correct the two material weaknesses, Integrated Financial Management System and Information Technology Security Controls.

3. Thank you again for your efforts in bringing us to another successful conclusion of the audit cycle.



William A. Moorman

## **SECTION IV**

### **DEPARTMENT OF VETERANS AFFAIRS FY 2004 ANNUAL PERFORMANCE AND ACCOUNTABILITY REPORT**

**PART III. Financial Section – Letter from the Acting Chief Financial Officer,  
Consolidated Financial Statements,  
Required Supplementary Stewardship Information (Unaudited), and  
Required Supplementary Information (Unaudited).**

**For the complete  
FY 2004 Annual Performance and Accountability Report  
See the attached compact disc  
Or the following web site:  
<http://www.va.gov/budget/report/>**

# A Letter from the Acting Chief Financial Officer

*I am pleased to report that the Department of Veterans Affairs continued its tradition of financial excellence in FY 2004. For the sixth straight year, VA received an unqualified audit opinion on its financial statements from the external auditors, Deloitte & Touche.*



We continue to strengthen our fiscal management and accountability by enhancing internal controls, complying with financial management laws and regulations, and taking timely corrective actions on the auditors' recommendations concerning reportable conditions, material weaknesses, and non-conformances.

In FY 2004, we continued our efforts to assess and correct the two outstanding audit material weaknesses reported by Deloitte & Touche — *Information Technology Security Controls* and *Lack of Integrated Financial Management System*. We have implemented an information technology security training and awareness program and established a VA centralized clearinghouse for computer-related security incidents, as well as made substantial progress in completing corrective actions within our application systems. In FY 2004, the Department deployed the CoreFLS pilot program at the Bay Pines VA Medical Center and two additional pilot sites. This pilot program was designed to test a new computerized financial management and logistics system and to demonstrate the ability of commercial off-the-shelf finance/logistics software to operate effectively in a complex VA environment. However, due to technology and other issues, management decided to discontinue the pilot and return the pilot sites to VA's existing financial management system by the beginning of FY 2005. An executive project committee, chaired by VA's Assistant Secretary for Information and Technology (VA CIO) and comprised of other senior leaders, is examining the results of the CoreFLS pilot program at the Bay Pines VA Medical Center, as well as the other two pilot sites, and will make recommendations to the VA Secretary concerning the future of the program.

Under FMFIA, VA corrected one material weakness, *Compensation and Pension System — Lack of Adaptability and Documentation*. We are currently working on the closure of the remaining two material weaknesses, *Personnel Accounting Integrated Data (PAID) System — Mission Performance* and *Internal Control Weaknesses in the Compensation and Pension Payment Process*, which are expected to be closed in early FY 2005 and FY 2006, respectively. We continued efforts to implement the requirements of the Improper Payments Information Act (IPIA). VA successfully completed a statistical sampling of 17 of the 19 programs in VA's IPIA inventory. The remaining two programs will be sampled in FY 2005.

The Department also continues to make progress in implementing the Government Performance and Results Act. We are continuously assessing and refining our performance measures, the quality of data used to compute those measures, and procedures for compiling performance data. Procedures are being developed to enhance data validation to ensure that our stakeholders have useful and accurate performance data.

While we are proud of our accomplishments in FY 2004, we will continue to strengthen and improve all aspects of our performance. Our goal is to maintain and/or exceed VA's high financial management standards in FY 2005. We will continue to promote effective management controls and focus on further actions associated with the President's Management Agenda initiatives.

A handwritten signature in black ink, appearing to read "William A. Moorman".

William A. Moorman

# Consolidated Financial Statements

## DEPARTMENT OF VETERANS AFFAIRS

### CONSOLIDATED BALANCE SHEETS (DOLLARS IN MILLIONS)

AS OF SEPTEMBER 30,

	2004	2003
<b>ASSETS</b>		
<b>INTRAGOVERNMENTAL</b>		
Fund Balance with Treasury (Note 3)	\$ 16,741	\$ 17,795
Investments (Note 5)	13,643	13,941
Accounts Receivable, Net (Note 6)	132	196
Other Assets	122	96
<b>TOTAL INTRAGOVERNMENTAL ASSETS</b>	<b>30,638</b>	<b>32,028</b>
<b>PUBLIC</b>		
Investments (Note 5)	184	201
Accounts Receivable, Net (Note 6)	887	859
Loans Receivable, Net (Note 7)	2,954	4,655
Cash (Note 4)	68	41
Inventories (Note 8)	69	73
General Property, Plant and Equipment, Net (Note 9)	11,215	10,949
Other Assets	56	29
<b>TOTAL PUBLIC ASSETS</b>	<b>15,433</b>	<b>16,807</b>
<b>TOTAL ASSETS</b>	<b>\$ 46,071</b>	<b>\$ 48,835</b>
<b>LIABILITIES</b>		
<b>INTRAGOVERNMENTAL</b>		
Accounts Payable	\$ 72	\$ 61
Debt	2,618	2,854
Other Liabilities (Note 13)	2,134	3,506
<b>TOTAL INTRAGOVERNMENTAL LIABILITIES</b>	<b>4,824</b>	<b>6,421</b>
<b>PUBLIC</b>		
Accounts Payable	3,003	2,907
Liabilities for Loan Guarantees (Note 7)	4,740	4,756
Federal Employee and Veterans Benefits Liability (Note 11)	926,553	956,688
Environmental and Disposal Liabilities (Note 12)	339	375
Insurance Liabilities (Note 15)	12,291	12,640
Other Liabilities (Note 13)	7,047	6,309
<b>TOTAL PUBLIC LIABILITIES</b>	<b>953,973</b>	<b>983,675</b>
<b>TOTAL LIABILITIES</b>	<b>958,797</b>	<b>990,096</b>
<b>NET POSITION</b>		
Unexpended Appropriations	2,642	4,233
Cumulative Results of Operations	(915,368)	(945,494)
<b>TOTAL NET POSITION</b>	<b>(912,726)</b>	<b>(941,261)</b>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$ 46,071</b>	<b>\$ 48,835</b>

The accompanying Notes are an integral part of these financial statements.

## DEPARTMENT OF VETERANS AFFAIRS

## CONSOLIDATED STATEMENTS OF NET COST (DOLLARS IN MILLIONS)

FOR THE YEARS ENDED SEPTEMBER 30,

	2004	2003
<b>NET PROGRAM COSTS (NOTE 18)</b>		
Medical Care	\$ 25,396	\$ 23,576
Medical Education	1,111	1,036
Medical Research	898	826
Compensation	27,306	25,546
Pension	3,526	3,491
Education	2,037	1,740
Vocational Rehabilitation and Employment	676	649
Loan Guaranty	1,141	(988)
Insurance	63	91
Burial	332	325
<b>NET PROGRAM COSTS BEFORE CHANGES IN VETERANS BENEFITS ACTUARIAL LIABILITIES</b>	<b>62,486</b>	<b>56,292</b>
Compensation	(30,100)	105,800
Burial	100	(200)
<b>SUBTOTAL</b>	<b>(30,000)</b>	<b>105,600</b>
<b>NET NON-PROGRAM COSTS</b>	<b>781</b>	<b>582</b>
<b>NET COST OF OPERATIONS (NOTE 18)</b>	<b>\$ 33,267</b>	<b>\$ 162,474</b>

*The accompanying Notes are an integral part of these financial statements.*

**DEPARTMENT OF VETERANS AFFAIRS**  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2004**  
(DOLLARS IN MILLIONS)

	<b>Cumulative Results of Operations</b>	<b>Unexpended Appropriations</b>
<b>Beginning Balances</b>	\$ (945,494)	\$ 4,233
<b>Budgetary Financing Sources</b>		
Appropriations Received	-	62,179
Other Adjustments	-	(460)
Appropriations Used	63,325	(63,325)
Transfers-in	-	15
Nonexchange Revenue	5	-
Donations	28	-
<b>Other Financing Sources</b>		
Donations of Property	14	-
Transfers-out	(880)	-
Imputed Financing	1,252	-
Other	(351)	-
<b>Total Financing Sources</b>	<b>63,393</b>	<b>(1,591)</b>
Net Cost of Operations	(33,267)	-
<b>Ending Balances</b>	<b>\$ (915,368)</b>	<b>\$ 2,642</b>

**DEPARTMENT OF VETERANS AFFAIRS**  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2003**  
(DOLLARS IN MILLIONS)

	<b>Cumulative Results of Operations</b>	<b>Unexpended Appropriations</b>
<b>Beginning Balances</b>	\$ (840,350)	\$ 3,366
<b>Budgetary Financing Sources</b>		
Appropriations Received	-	59,060
Other Adjustments	(1,113)	1,092
Appropriations Used	59,285	(59,285)
Nonexchange Revenue	1	-
Donations	27	-
<b>Other Financing Sources</b>		
Donations of Property	15	-
Transfers-out	(1,925)	-
Imputed Financing	1,082	-
Other	(42)	-
<b>Total Financing Sources</b>	<b>57,330</b>	<b>867</b>
Net Cost of Operations	(162,474)	-
<b>Ending Balances</b>	<b>\$ (945,494)</b>	<b>\$ 4,233</b>

*The accompanying Notes are an integral part of these financial statements.*

## DEPARTMENT OF VETERANS AFFAIRS

## COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 19) (DOLLARS IN MILLIONS)

FOR THE YEAR ENDED SEPTEMBER 30, 2004

**Budgetary Resources**

	<b>Budgetary</b>	<b>Credit Financing</b>
Budget Authority	\$ 64,987	\$ 1,169
Unobligated Balance at the Beginning of the Period	16,208	6,150
Net Transfers-Prior Year Balance	(116)	-
Spending Authority from Offsetting Collections	4,955	2,944
Adjustments	(386)	(1,347)

**Total Budgetary Resources**

<b>\$ 85,648</b>	<b>\$ 8,916</b>
------------------	-----------------

**Status of Budgetary Resources**

Obligations Incurred	\$ 69,981	\$ 4,440
Unobligated Balance Available	13,232	1
Unobligated Balance Not Yet Available	2,435	4,475

**Total Status of Budgetary Resources**

<b>\$ 85,648</b>	<b>\$ 8,916</b>
------------------	-----------------

**Outlays**

Obligations Incurred	\$ 69,981	\$ 4,440
Less Spending Authority from Offsetting Collections and Adjustments	(4,955)	(2,944)
Obligated Balance, Net Beginning of Period	8,945	76
Less Obligated Balance, Net End of Period	(10,034)	(93)

**Outlays**

	63,937	1,479
--	--------	-------

Less Offsetting Receipts

(2,668)	-
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**Net Outlays**

<b>\$ 61,269</b>	<b>\$ 1,479</b>
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## DEPARTMENT OF VETERANS AFFAIRS

## COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 19) (DOLLARS IN MILLIONS)

FOR THE YEAR ENDED SEPTEMBER 30, 2003

**Budgetary Resources**

	<b>Budgetary</b>	<b>Credit Financing</b>
Budget Authority	\$ 61,723	\$ 1,334
Unobligated Balance at the Beginning of the Period	15,579	5,316
Net Transfers-Prior Year Balance	(105)	-
Spending Authority from Offsetting Collections	4,906	4,666
Adjustments	(206)	(1,506)

**Total Budgetary Resources**

<b>\$ 81,897</b>	<b>\$ 9,810</b>
------------------	-----------------

**Status of Budgetary Resources**

Obligations Incurred	\$ 65,689	\$ 3,660
Unobligated Balance Available	13,708	218
Unobligated Balance Not Yet Available	2,500	5,932

**Total Status of Budgetary Resources**

<b>\$ 81,897</b>	<b>\$ 9,810</b>
------------------	-----------------

**Outlays**

Obligations Incurred	\$ 65,689	\$ 3,660
Less Spending Authority from Offsetting Collections and Adjustments	(4,906)	(4,666)
Obligated Balance, Net Beginning of Period	7,819	103
Less Obligated Balance, Net End of Period	(8,945)	(76)

**Outlays**

	59,657	(979)
--	--------	-------

Less Offsetting Receipts

(2,174)	-
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**Net Outlays**

<b>\$ 57,483</b>	<b>\$ (979)</b>
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The accompanying Notes are an integral part of these financial statements.

**DEPARTMENT OF VETERANS AFFAIRS**  
**CONSOLIDATED STATEMENTS OF FINANCING (NOTE 20)**  
**FOR THE YEARS ENDED SEPTEMBER 30,**  
**(DOLLARS IN MILLIONS)**

	<b>2004</b>	<b>2003</b>
<b>Resources Used to Finance Activities</b>		
Obligations Incurred	\$ 74,421	\$ 69,349
Less Spending Authority from Offsetting Collections and Adjustments	(7,899)	(9,572)
Obligations Net of Offsetting Collections and Adjustments	66,522	59,777
Less Offsetting Receipts	(2,668)	(2,174)
Net Obligations	63,854	57,603
Donations of Property	14	15
Transfers-out	(1,227)	(1,925)
Imputed Financing	1,252	1,082
Other Financing Sources	3	(42)
<b>Total Resources Used to Finance Activities</b>	<b>63,896</b>	<b>56,733</b>
<b>Resources That Do Not Fund Net Cost of Operations</b>		
Change in Amount of Goods, Services and Benefits Ordered But Not Yet Provided	(452)	(357)
Resources that Finance the Acquisition of Assets	(5,398)	(4,428)
Resources that Fund Expenses Recognized in Prior Periods	(441)	(1,105)
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations	3,065	4,812
Other	(3)	2
Total Resources That Do Not Fund Net Costs of Operations	(3,229)	(1,076)
<b>Total Resources Used to Finance the Net Cost of Operations</b>	<b>60,667</b>	<b>55,657</b>
<b>Costs That Do Not Require Resources in the Current Period</b>		
Increase in Annual Leave Liability	75	55
Increase in Environmental and Disposal Liability	(37)	104
Reestimates of Credit Subsidy Expense	2,148	(565)
Increase in Exchange Revenue Receivable from the Public	952	157
Increase in Veterans Benefits Actuarial Liability	(30,000)	105,600
Depreciation and Amortization	465	1,345
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	328	194
Loss on Disposition of Assets	99	109
Other	(1,430)	(182)
<b>Total Costs That Do Not Require Resources in the Current Period</b>	<b>(27,400)</b>	<b>106,817</b>
<b>Net Cost of Operations</b>	<b>\$ 33,267</b>	<b>\$ 162,474</b>

*The accompanying Notes are an integral part of these financial statements.*



# Notes

## Notes to Consolidated Financial Statements

*For the Years Ended September 30, 2004 and 2003 (dollars in millions, unless otherwise noted).*

### 1. Summary of Significant Accounting Policies

#### Basis of Presentation

The Department of Veterans Affairs' (VA) consolidated financial statements report all activities of VA components, including the Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), National Cemetery Administration (NCA), and staff organizations. The consolidated financial statements meet the requirements of the Chief Financial Officers (CFO) Act of 1990 and the Government Management Reform Act (GMRA) of 1994. The consolidated financial statements differ from the financial reports used to monitor and control budgetary resources, but are prepared from the same books and records. The statements should be read with the understanding that VA is a component unit of the U.S. Government. VA fiscal year (FY) 2004 and (FY) 2003 financial statements are presented in conformity with the Office of Management and Budget's (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements," as amended.

#### Reporting Entity

The mission of VA is to provide medical care, benefits, social support, and lasting memorials to veterans, their dependents, and beneficiaries [(38 U.S.C. Section 301(b) 1997)].

The Department is organized under the Secretary of VA. The Secretary's office includes a Deputy Secretary and has direct lines of authority over the Under Secretary for Health, the Under Secretary for Benefits, and the Under Secretary for Memorial Affairs. Additionally, six Assistant Secretaries, an Inspector General, a General Counsel,

and the chairmen of the Board of Contract Appeals and the Board of Veterans' Appeals support the Secretary.

#### Budgets and Budgetary Accounting

Budgetary accounting measures appropriation and consumption of budget/spending authority or other budgetary resources, and facilitates compliance with legal constraints and controls over the use of Federal funds. Under budgetary reporting principles, budgetary resources are consumed at the time of the purchase. Assets and liabilities that do not consume budgetary resources are not reported, and only those liabilities for which valid obligations have been established are considered to consume budgetary resources.

#### Basis of Accounting

The accompanying consolidated financial statements have been prepared in accordance with Federal Accounting Standards Advisory Board (FASAB) standards. The Comptroller General, the Secretary of the Treasury, and the Director of the OMB sponsor FASAB, which determines Federal accounting concepts and standards.

#### Revenues and Other Financing Sources

Exchange revenues are recognized when earned to the extent the revenue is payable to VA from other Federal agencies or the public as a result of costs incurred or services performed on its behalf. Revenue is recognized at the point the service is rendered. Imputed financing sources consist of imputed revenue for expenses relating to legal claims paid by Treasury's Judgment Fund and post-retirement benefits for VA employees. Non-exchange revenue, e.g., donations, is

recognized when received, and related receivables are recognized when measurable and legally collectible, as are refunds and related offsets.

## Accounting for Intragovernmental Activities

VA, as a department of the Federal Government, interacts with and is dependent upon the financial activities of the Federal Government as a whole. Therefore, these consolidated financial statements do not reflect the results of all financial decisions applicable to VA as though the department were a stand-alone entity.

In order to prepare reliable financial statements, transactions occurring among VA components must be eliminated. All significant intra-entity transactions were eliminated from VA's consolidated financial statements.

## Fund Balance with Treasury

The Department of the Treasury (Treasury) performs cash management activities for all Federal Government agencies. The Fund Balance with Treasury represents the right of VA to draw on the Treasury for allowable expenditures. Trust fund balances consist primarily of amounts related to the Post-Vietnam Educational Assistance Trust Fund, the National Service Life Insurance (NSLI) Fund, the United States Government Life Insurance (USGLI) Fund, the Veterans Special Life Insurance (VSLI) Fund, General Post Fund, and the National Cemetery Gift Fund. The use of these funds is restricted.

## Cash

Cash consists of Canteen Service and Loan Guaranty Program amounts held in commercial banks, cash held by non-federal trusts, as well as Agent Cashier advances at VA field stations. Treasury processes all other cash receipts and disbursements. Amounts relating to the Loan Guaranty Program represent deposits with trustees for offsets against loan loss claims related to sold loan portfolios.

## Investments

Investments are reported at cost and are redeemable at any time for their original purchase price. Insurance program investments, which comprise most of VA's investments, are in non-marketable Treasury special bonds and certificates. Interest rates for Treasury special securities are based on average market yields for comparable Treasury issues. Special bonds, which mature during various years through the year 2019, are generally held to maturity unless needed to finance insurance claims and dividends. Other program investments are in securities issued by Treasury, with the exception of Insurance Program holdings in stock received from Prudential as a result of its demutualization and the Loan Guaranty Program investments in trust certificates issued by the American Housing Trusts.

Allowances are recorded to reflect estimated losses of principal as a result of the subordinated position in American Housing Trust certificates I through V. The estimated allowance computations are based upon discounted cash flow analysis. Although VA continues to use the income from these subordinated certificates to cover the immediate cash requirements of the Federal guarantee on loans sold under American Housing Trust certificates VI through XI and the Veterans Mortgage Trust program, the income is reimbursed to VA and is not used to pay the amount of the realized losses on guaranteed loan sales.

## Accounts Receivable

Intragovernmental accounts receivable consists of amounts due from other Federal Government agencies. No allowances for losses are required.

Public accounts receivable consists mainly of amounts due for veterans' health care and amounts due for compensation, pension, and readjustment benefit overpayments. Allowances are based on prior experience. For FY 2004, contractual

adjustments were 52 percent and bad debt allowances for medical-related receivables were 9 percent. For FY 2003, contractual adjustments were 52 percent and bad debt allowances for medical-related receivables were 9 percent. Educational-related receivables bad debt allowances were 44 percent for FY 2004 and 37 percent for FY 2003. Compensation and pension benefits overpayment-related bad debt receivables were 72 percent for FY 2004 and 74 percent for FY 2003.

VA is required by Public Law 96-466 to charge interest and administrative costs on benefits debts similar to charges levied on other debts owed the Federal Government. In a July 1992 decision, the former VA Deputy Secretary decided that VA would not charge interest on compensation and pension debts. This decision continues to be VA policy.

## Loans Receivable

Loans Receivable are recorded as funds are disbursed. For loans obligated prior to October 1, 1991, loan principal and interest receivable amounts are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on past experience and an analysis of outstanding balances. For loans obligated after September 30, 1991, an allowance equal to the subsidy costs associated with these loans reduces the loans receivable. This reduction is due to the interest rate differential between the loans and borrowing from Treasury, the estimated delinquencies and defaults, net of recoveries, offsets from fees, and other estimated cash flows.

## Inventories

Inventories consist of items such as precious metals held for sale and Canteen Service retail store stock and are valued at cost. VA follows the purchase method of accounting for operating supplies, medical supplies, and pharmaceutical supplies in the hands of end users. The purchase method provides that these items be expensed when purchased. VA defines an end user as a VA medical center, regional office, or cemetery.

## Property, Plant, and Equipment

The majority of the general property, plant, and equipment is used to provide medical care to veterans and is valued at cost, including transfers from other Federal agencies. Major additions, replacements, and alterations are capitalized, whereas routine maintenance is expensed when incurred. Construction costs are capitalized as Construction in Progress until completion, and then transferred to the appropriate property account. Individual items are capitalized if the useful life is 2 years or more and the unit price is \$100,000 or greater. Buildings are depreciated on a straight-line basis over estimated useful lives of 25 to 40 years. Equipment is also depreciated on a straight-line basis over its useful life, usually 5 to 20 years. There are no restrictions on the use or convertibility of general property, plant, and equipment. All VA heritage assets are multi-use facilities and are classified as general property, plant, and equipment.

## Other Assets

Other assets consist of advance payments. Public advance payments are primarily to hospitals and medical schools under house staff contracts, grantees, beneficiaries, and employees on official travel. Intragovernmental advance payments are primarily to the General Services Administration (GSA) for rent and Government Printing Office (GPO) for supplies, printing, and equipment.

## Accounts Payable

Intragovernmental accounts payable consists of amounts owed to other Federal Government agencies. The remaining accounts payable consist of amounts due to the public.

## Loan Guarantees

For direct loan obligations and loan guaranty commitments made after 1991, the resulting direct loans are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value. The present value of the subsidy costs

associated with direct loans and loan guarantees is recognized as a cost in the year the direct or guaranteed loan is disbursed. Pre-1992 direct loans and loan guarantees are reported under the allowance for loss method. The nominal amount of the direct loan is reduced by an allowance for uncollectible amounts, and the liability for loan guarantees is the amount VA estimated will most likely require a future cash outflow to pay defaulted claims. Interest is accrued on VA-owned loans by computing interest on a loan-by-loan basis at the end of the month and recording the amount owed as an accrual.

The guaranteed loan sales liability represents the present value of the estimated cash flows to be paid by VA as a result of the guarantee. VA guarantees that the principal and interest payment due on a loan will be paid by the 15<sup>th</sup> of each month. If the payment is not made, VA allows the loan servicer to receive funds from a cash reserve account for the amount of the deficiency. VA guarantees the loans against losses at foreclosure. Although VA will not buy back the loan, VA will pay the loan loss and foreclosure expenses.

## Debt

All intragovernmental debt is due to Treasury and is primarily related to borrowing by the Loan Guaranty Program. The interest rates ranged from 1.29 to 5.24 percent in FY 2004 and from 1.20 to 5.03 percent in FY 2003. VA's financial activities interact with and are dependent upon those of the Federal Government as a whole.

## Insurance Liabilities

Actuarial reserve liabilities for VA's insurance programs are based on mortality and interest rate assumptions at the time of issue. These assumptions vary by fund, type of policy, and type of benefit. The interest rate assumptions range from 2.25 to 5.0 percent for both the FY 2004 and FY 2003 calculations.

## Annual Leave

The accrued annual leave balance is adjusted at the end of the fiscal year to reflect current pay rates for leave that has been earned but not taken. Sick and other types of non-vested leave are expensed as taken. To the extent appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources.

## Workers' Compensation Liability

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. Claims incurred for benefits for VA employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by VA.

Workers' compensation is comprised of two components: (1) the accrued liability which represents money owed by VA to DOL for claims paid by DOL on behalf of VA through the current fiscal year, and (2) the actuarial liability for compensation cases to be paid beyond the current year.

Future workers' compensation estimates are generated from an application of actuarial procedures developed by DOL to estimate the liability for FECA benefits. The liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases and for potential cases related to injuries incurred but not reported. The liability is determined by utilizing historical benefit payment patterns related to a particular period to estimate the ultimate payments related to that period.

## Pension, Other Retirement Benefits, and Other Post-Employment Benefits

Each employing Federal agency is required to recognize its share of the cost and imputed financing of providing

pension and post-retirement health benefits and life insurance to its employees. Factors used in the calculation of these pensions and post-retirement health and life insurance benefit expenses are provided by the Office of Personnel Management (OPM) to each agency.

VA's employees are covered under the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) to which VA makes contributions according to plan requirements. CSRS and FERS are multi-employer plans. VA does not maintain or report information about the assets of the plans, nor does it report actuarial data for the accumulated plan benefits. That reporting is the responsibility of OPM.

### Veterans Benefits Liability

VA provides compensation benefits to veterans who are disabled by military service-related causes. Benefits are also provided to deceased veterans' beneficiaries. These benefits are provided in recognition of a veteran's military service. The liability for future compensation payments is reported on VA's balance sheet at the present value of expected future payments, and is developed on an actuarial basis. Various assumptions in the actuarial model, such as the number of veterans and dependents receiving payments, discount rates, cost of living adjustments and life expectancy, impact the amount of the liability.

### Litigation

VA is a party in various administrative proceedings, legal actions, and claims brought against it. In the opinion of VA management and legal counsel, the ultimate resolutions of these proceedings, actions, and claims will not materially affect the financial position or results of VA operations.

### Non-Federal Trusts

VA has entered into enhanced-use leases to maximize use of underutilized VA property. In seven of these enhanced-use leases, the assets and liabilities were transferred to a non-Federal trust. In FY 2004, the assets, liabilities, and results of operations of these seven trusts are consolidated in VA's consolidated financial statements.

### Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein. In FY 2004, VA changed its estimate of medical malpractice and other tort liabilities to discount the liability and changed the method used to estimate credit subsidy amounts to the balances approach method. See Notes 16 and 7, respectively.

## 2. Non-Entity Assets

Entity and Non-Entity assets have been combined on the face of the balance sheet. Non-Entity assets relate primarily to patient funds.

#### Non-Entity Assets as of September 30,

	2004	2003
Fund Balance with Treasury	\$ 47	\$ 56
Intragovernmental Accounts Receivable	1	1
Public Accounts Receivable	11	14
<b>Total Non-Entity Assets</b>	<b>\$ 59</b>	<b>\$ 71</b>

### 3. Fund Balance With Treasury

**Fund Balance with Treasury  
as of September 30,**

	2004	2003
<b>Entity Assets</b>		
Trust Funds	\$ 86	\$ 89
Revolving Funds	5,661	7,190
Appropriated Funds	10,917	10,427
Special Funds	156	116
Other Fund Types	(126)	(83)
Total Entity Assets	\$ 16,694	\$ 17,739
<b>Non-Entity Assets</b>		
Other Fund Types	47	56
Total Non-Entity Assets	47	56
<b>Total Entity and Non-Entity Assets</b>	\$ 16,741	\$ 17,795
<b>Reconciliation of VA General Ledger Balances with Treasury</b>		
Entity VA General Ledger	\$ 17,159	\$ 17,867
Reconciled Differences	(433)	(75)
Unreconciled Differences	15	3
Fund Balance with Treasury	\$ 16,741	\$ 17,795
<b>Status of Fund Balance with Treasury</b>		
Unobligated Balance		
Available	\$ 3,558	\$ 2,153
Unavailable	4,943	6,554
Obligated Balance not yet Disbursed	8,319	9,114
Deposit/Clearing Account Balances	(79)	(26)
Fund Balance with Treasury	\$ 16,741	\$ 17,795

### 4. Cash

**Cash  
as of September 30,**

	2004	2003
Canteen Service	\$ 3	\$ 1
Agent Cashier Advance	19	4
Loan Guaranty Program	4	36
Funds held by non-federal trusts	42	-
<b>Total Cash</b>	\$ 68	\$ 41



## 5. Investments

### Investment Securities as of September 30,

		2004	2003
<b>Intragovernmental Securities</b>	Interest Range		
Special Bonds	3.25-9.5%	\$ 13,329	\$ 13,618
Treasury Notes *	1.62-4.25%	67	92
Treasury Bills	0.91-1.95%	30	2
Subtotal		13,426	13,712
Accrued Interest		217	229
<b>Total Intragovernmental Securities</b>		<b>\$ 13,643</b>	<b>\$ 13,941</b>
<b>Other Securities</b>			
Prudential Stock (Insurance)		\$ 6	\$ 9
Trust Certificates (Loan Guaranty)		178	192
<b>Total Other Securities</b>		<b>\$ 184</b>	<b>\$ 201</b>

\*The investment in Treasury Notes includes unamortized premiums of \$0.1 million as of September 30, 2004 and \$0.7 million as of September 30, 2003. Premiums and discounts are amortized on a straight-line basis over the life of the investments.

### Offset for Losses on Investments as of September 30,

	2004	2003
Investment in Subordinate Certificates at Time of Sale	\$ 424	\$ 425
Cumulative Reductions	(238)	(224)
<b>Subtotal</b>	<b>186</b>	<b>201</b>
Allocation of Loss Provision	(8)	(9)
<b>Trust Certificates (Loan Guaranty)</b>	<b>\$ 178</b>	<b>\$ 192</b>

## 6. Accounts Receivable, Net

### Accounts Receivable, Net as of September 30,

	2004	2003
<b>Intragovernmental Accounts Receivable</b>	<b>\$ 132</b>	<b>\$ 196</b>
Public Accounts Receivable, Gross	\$ 2,088	\$ 2,029
Allowance for Loss Provision	(1,201)	(1,170)
<b>Net Public Accounts Receivable</b>	<b>\$ 887</b>	<b>\$ 859</b>

## 7. Direct Loans and Loan Guarantees

Direct loan obligations and loan guarantee commitments made after 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act of 1990. The Act provides that the present value of the subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the direct or guaranteed loan is disbursed. Direct loans are reported net of an allowance for subsidy costs at present value, and loan guarantee liabilities are reported at present value. Pre-1992 direct loans and loan guarantees are reported under the allowance for loss method. The nominal amount of the direct loan is reduced by an allowance for uncollectible amounts, and the liability for loan guarantees is the amount VA estimates will most likely require a future cash outflow to pay defaulted claims.

Interest is accrued on VA-owned loans by computing interest on a loan-by-loan basis at the end of the month and recording the amount owed as an accrual.

The recorded value of loans receivable, net, and the value of assets related to direct loans are not the same as the proceeds that VA would expect to receive from selling its loans. VA operates the following direct loan and loan guaranty programs:

- Vocational Rehabilitation and Employment.
- Education.
- Insurance.
- Loan Guaranty.

Under the Loan Guaranty Program, a loan may be made to an eligible veteran by an approved private sector mortgage lender. VA guarantees payment of a fixed percentage of the loan indebtedness to the holder of such a loan, up to a maximum dollar amount, in the event of default by the veteran borrower. Occasionally, a delinquency is reported to VA and neither a realistic alternative to foreclosure is offered by the loan holder nor is VA in a position to supplementally service the loan. In such cases, VA determines, through an economic analysis, whether VA will authorize the holder to convey the property securing the loan (foreclosure) or pay the loan guarantee amount to the holder.

### Direct Loans

Loans receivable related to direct loans represent the net value of assets related to acquired pre-1992 and post-1991 direct loans. For pre-1992 loans, VA employs the allowance for loss method in which the assets are offset by an allowance for loan losses (estimated uncollectible loans). For post-1991 loans, the assets are offset by an allowance for subsidy costs. An analysis of loans receivable and the nature and amounts of the subsidy costs associated with the direct loans are provided in the tables that follow:



### Loans Receivable and Related Foreclosed Property From Direct Loans

as of September 30, 2004	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	\$ 82	\$ 7	\$ -	\$ -	\$ 89
Direct Loans Obligated after 1991	1,051	29	(166)	93	1,007
Insurance Policy Loans	716	17	-	-	733
<b>Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net</b>					<b>\$ 1,829</b>

### Loans Receivable and Related Foreclosed Property From Direct Loans

as of September 30, 2003	Loans Receivable Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Loans
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)	\$ 114	\$ 15	\$ -	\$ -	\$ 129
Direct Loans Obligated after 1991	1,585	29	1,136	87	2,837
Insurance Policy Loans	770	19	-	-	789
<b>Total Loans Receivable and Related Foreclosed Property from Direct Loans, Net</b>					<b>\$ 3,755</b>

## Direct Loans Disbursed

The total amount of direct loans disbursed for the years ended September 30, 2004 and 2003, was \$123 and \$563 million, respectively.

## Provision for Losses on Pre-1992 Loans

The present value of the cost VA will bear as loans already guaranteed default is an element of the mortgage loan benefit that VA provides to veterans. This cost is reflected in the financial statements as an offset to the value of certain related assets.

The provision for losses on vendee loans is based upon historical loan foreclosure results applied to the average loss on defaulted loans. The calculation is also based on the use of the average interest rate of U.S. interest-bearing debt as a discount rate on the assumption that VA's outstanding guaranteed loans will default over a 12-year period. For FY 2004, VA determined that these vendee loans have sufficient equity due to real estate appreciation and buy-down of principal, to minimize or eliminate any potential loss to VA. The components of the provision are as follows:

Provision for Loss  
as of September 30,

Offsets Against Foreclosed Property Held for Sale

**Total Provision for Loss**

	<b>2004</b>	<b>2003</b>
	10	8
	<u>\$ 10</u>	<u>\$ 8</u>

## Subsidy Expense for Post-1991 Direct Loans

Pursuant to the Credit Reform Act, all direct loans established after September 30, 1991, will be subsidized. The subsidy expense for direct loans is as shown:

Direct Loan Subsidy Expense  
for the years ended September 30,

Interest Differential

Defaults\*

Fees\*\*

Other\*\*\*

**Subtotal**

Interest Rate Reestimates

Technical Reestimates

**Total Direct Loans**

	<b>2004</b>	<b>2003</b>
\$	(6)	\$ (55)
	3	12
	0	(9)
	4	44
	<u>1</u>	<u>(8)</u>
	473	(178)
	922	(44)
\$	<u>1,396</u>	<u>\$ (230)</u>

\* Includes approximately \$50,000 and \$42,000 in defaults and other expenses for the Vocational Rehabilitation Program for FY 2004 and 2003, respectively.

\*\* "Fees" expense for direct loans includes estimated down payments and other fees collected when homes are sold with vendee financing.

\*\*\* The "Other" expense for direct loans includes the estimated loss of scheduled principal and interest when vendee loans are sold.

## Subsidy Rates for Direct Loans by Component

The subsidy rates disclosed below pertain only to the current year cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

Subsidy rates for direct loans

Interest Differential

Defaults

Fees

Other

(17.19%)

12.8%

(0.44%)

7.28%

## Allowance for Subsidy for Direct Loans (Post-1991)

VA reports the allowance for subsidy for direct loans, subject to Credit Reform requirements. For these loans, the allowance for subsidy represents the present value of the estimated net cash flows to be paid by VA as a result of a disbursed direct loan. VA disburses a direct loan and receives an allowance for subsidy along with borrowing from Treasury. For FY 2004, the subsidy rate for October through December is (11.16) and the subsidy rate for January through September is (2.48). In FY 2003 the rate was 0.86 percent. The allowance for subsidy as of September 30, 2004 and 2003 is \$166 and (\$974) million, respectively.

### Schedule for Reconciling Subsidy Cost Allowance Balances

<b>Beginning Balance, Changes and Ending Balance</b>	<b>FY 2004</b>	<b>FY 2003</b>
Beginning balance of the allowance	\$ (1,136)	\$ (853)
Subsidy expense for direct loans disbursed during the reporting years by component:		
Interest subsidy costs	(6)	(55)
Default costs (net of recoveries)	3	12
Fees and other collections	0	(9)
Other subsidy costs	4	44
Total of the above subsidy expense components	1	(8)
Adjustments:		
Loan modification	0	0
Fees received	1	11
Foreclosed property acquired	(21)	(5)
Loans written off	(9)	(6)
Subsidy allowance amortization	(65)	(53)
Other	0	0
Ending balance of the allowance before reestimates	(1,229)	(914)
Subsidy reestimates by component		
Interest rate reestimate	473	(44)
Technical/default reestimate	922	(178)
Total of the above reestimate components	1,395	(222)
Ending balance of the allowance	\$ 166	\$ (1,136)

## Loan Guarantees

Loans receivable related to loan guarantees represent the net value of assets related to pre-1992 and post-1991 defaulted guaranteed loans and non-defaulted guaranteed loans. For pre-1992 loans, VA employs the allowance for loss method in which the assets are offset by an allowance for loan losses (estimated uncollectible loans). An analysis of loans receivable, loan guarantees, the liability for loan guarantees, and the nature and amounts of the subsidy costs associated with loan guarantees are provided in the tables that follow:

### Loans Receivable and Related Foreclosed Property from Loan Guarantees as of September 30,

<b>2004</b>	<b>Loans Receivable Gross</b>	<b>Interest Receivable</b>	<b>Allowance for Loan Losses</b>	<b>Foreclosed Property</b>	<b>Value of Assets Related to Loans</b>
Defaulted Guaranteed Loans Pre-1992 Guarantees	129	1	(121)	45	54
Defaulted Guaranteed Loans Post-1991	-	-	-	1,071	1,071
<b>Total Loans Receivable and Related Foreclosed Property from Loan Guarantees</b>					<b>\$ 1,125</b>

### Loans Receivable and Related Foreclosed Property from Loan Guarantees as of September 30,

<b>2003</b>	<b>Loans Receivable Gross</b>	<b>Interest Receivable</b>	<b>Allowance for Loan Losses</b>	<b>Foreclosed Property</b>	<b>Value of Assets Related to Loans</b>
Defaulted Guaranteed Loans Pre-1992 Guarantees	147	4	(138)	46	59
Defaulted Guaranteed Loans Post-1991	-	-	-	841	841
<b>Total Loans Receivable and Related Foreclosed Property from Loan Guarantees</b>					<b>\$ 900</b>

### Total Loans Receivable and Related Foreclosed Property, Net for the years ended September 30,

	<b>2004</b>	<b>2003</b>
Total Direct Loans	\$ 1,829	\$ 3,755
Total Guaranteed Loans	1,125	900
<b>Total Loans Receivable and Related Foreclosed Property, Net</b>	<b>\$ 2,954</b>	<b>\$ 4,655</b>

## Foreclosed Property

Prior to the foreclosure of property secured by a VA loan, VA obtains an independent appraisal of the property. This appraisal is reviewed by VA staff who make a determination of the fair market value. To determine the net value of the property, VA expenses such as costs for acquisition, management, and disposition of the property, as well as estimated losses on property resale, are subtracted from the estimated fair market value. As of September 30, 2004 and 2003, the estimated number of residential properties in VA's inventory was 15,539 and 11,872, respectively. For FY 2004 and FY 2003, the average holding period from the date properties were conveyed to VA until the properties were sold was estimated to be 10.1 months and 8.9 months, respectively. The number of properties for which foreclosure proceedings are in process is estimated to be 10,355 and 10,513 as of September 30, 2004 and 2003, respectively.

Guaranteed Loans as of September 30,	2004	2003
<u>Guaranteed Loans Outstanding:</u>		
Outstanding Principal Guaranteed Loans, Face Value	\$ 207,374	\$ 213,248
Amount of Outstanding Guarantee	64,683	67,654
<u>New Guaranteed Loans Disbursed:</u>		
Outstanding Principal Guaranteed Loans, Face Value	\$ 44,130	\$ 63,255
Amount of Outstanding Guarantee	12,643	18,245
<b>Liabilities for Loan Guarantees Post 1991 (Present Value)</b>	<b>\$ 4,740</b>	<b>\$ 4,756</b>

## Guaranty Commitments

As of September 30, 2004, VA had outstanding commitments to guarantee loans that will originate in FY 2005. The number and amount of commitments could not be determined, as VA has granted authority to various lenders to originate VA loans that meet established criteria without prior VA approval. Nearly 90 percent of VA's guaranteed loans originate under this authority.

## Subsidy Expense for Post-1991 Loan Guarantees

Pursuant to the Credit Reform Act, guaranteed loans closed after September 30, 1991, will be subsidized. The subsidy expense for loan guarantees related to the Loan Guaranty Program is as shown:

Guaranteed Loan Subsidy Expenses for the years ended September 30,	2004	2003
Defaults	\$ 652	\$ 1,678
Fees*	(470)	(1,145)
Other**	0	0
Subtotal	182	533
Interest Rate Reestimates	(241)	(471)
Technical Reestimates	(542)	(1,407)
<b>Total Guaranteed Loan Subsidy Expense</b>	<b>\$ (601)</b>	<b>\$ (1,345)</b>

\* The "Fees" expense includes estimated up-front fees collected when the loans are guaranteed and the present value of estimated annual fees from loan assumptions.

\*\* The "Other" expense for guaranteed loans includes estimated recoveries on defaults through the sales of foreclosed properties.

Loan Sale-Guaranteed Loan Subsidy Expense  
for the years ended September 30,

	2004	2003
Defaults	\$ 19	\$ 14
Other	(2)	0
Subtotal	17	14
Interest Rate Reestimates	102	(50)
Technical Reestimates	80	(109)
<b>Total Loan Sale-Guaranteed Subsidy Expense</b>	<b>\$ 199</b>	<b>\$ (145)</b>

Total Subsidy Expense  
for the years ended September 30,

	2004	2003
Total Direct Loans	\$ 1,396	\$ (230)
Total Guaranteed Loans	(601)	(1,345)
Total Sale Loans	199	(145)
<b>Total Subsidy Expense</b>	<b>\$ 994</b>	<b>\$ (1,720)</b>

## Subsidy Rates for Loan Guarantees by Component

The subsidy rates disclosed below pertain only to the current year cohorts. These rates cannot be applied to the guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loan guarantees reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes reestimates.

Subsidy Rates for Loan Guarantees

Defaults	1.85%
Fees	(1.33%)
Other	0

## Loan Sales

VA continues to have vendee loan sales to reduce the administrative burden of servicing vendee loans. During the period FY 1992 through FY 2004, the total loans sold amounted to \$13.8 billion. Under the sale of vendee loans, certificates are issued pursuant to the Pooling and Servicing Agreement (the Agreement) among VA, the Master Servicer, and the Trustee. On the closing date of the certificates, VA transfers its entire interest in the related loans to the Trustee for the benefit of the related certificate holders pursuant to the Agreement. Under the Agreement, the Trust will issue certificates backed

by mortgage loans and installment contracts. The Trust owns the mortgage loans and other property described in the offering and the Trust makes elections to treat certain of its assets as one or more Real Estate Mortgage Investment Conduits (REMIC) for U.S. Federal income tax purposes. The certificates represent interests in the assets of the Trust and are paid from the Trust's assets. The certificates are issued as part of a designated series that may include one or more classes. VA guarantees that the investor will receive full and timely distributions of the principal and interest on the certificates and that guaranty is backed by the full faith and credit of the Federal Government.

VA may terminate the Trust, causing the early retirement of certificates, by purchasing all of the Trust's assets on any distribution date on or after the distribution date on which the current aggregate principal balance of all principal certificates is less than 1 percent of the original aggregate principal balance, or if VA determines that the Trust's REMIC status has been lost or a substantial risk exists that such status will be lost. In the event of termination, the certificate holder will be entitled to receive payment for the full principal balance of the certificates plus any accrued interest and unpaid interest through the related distribution date.

The Agreement requires the mortgage loans to be serviced generally in compliance with Fannie Mae and Freddie Mac standards and consistent with prudent residential mortgage loan servicing standards generally accepted in the servicing industry. For mortgage loans sold during FY 2004, servicing was performed by

Countrywide Home Loans, Inc. (Master Servicer). The Master Servicer is responsible for the performance of all of the servicing functions under the Agreement. The Master Servicer is entitled to be compensated by receiving (1) a service fee of 0.2075 percent per annum payable monthly and calculated by multiplying the interest payment received by a fraction, the numerator of which is 0.2075 percent and the denominator of which is the mortgage interest rate on such loan; (2) earnings on investment of funds in the certificate account; and (3) all incidental fees and other charges paid by the borrowers and a portion of the liquidation proceeds in connection with the liquidated loans.

VA completed one sale during FY 2004 and one sale during FY 2003 totaling approximately \$298 million and \$283 million of vendee loans, respectively. The components of the vendee sales are summarized in the tables below:

Loan Sales Years ended September 30,	2004	2003
Loans Receivable Sold	\$ 298	\$ 283
Net Proceeds From Sale	308	299
<b>Loss (Gain) on Receivables Sold</b>	<b>\$ (10)</b>	<b>\$ (16)</b>

## Outstanding Balance of Loan Sale Guarantees

All loans sold under the American Housing Trust (AHT VI through AHT XI) and the Vendee Mortgage (VMT 92-1 through 03-1) programs carry a full government guarantee. The outstanding balance for guaranteed loans sold is summarized in the table below:

Guaranteed Loans Sold as of September 30,	2004	2003
Outstanding Balance Guaranteed Loans Sold, Start of Year	\$ 5,569	\$ 7,406
Sold to the Public	298	283
Payments, Repayments, and Terminations	(1,679)	(2,120)
<b>Outstanding Balance Guaranteed Loans Sold, End of Year</b>	<b>\$ 4,188</b>	<b>\$ 5,569</b>

## Liability for Loan Sale Guarantees (Post-1991)

VA reports the liability on the guarantee of loans sold under the Vendee Mortgage Trust and American Housing Trust programs, subject to Credit Reform requirements. For these loans, the guaranteed loan sale liability represents the present value of the estimated net cash flows to be paid by VA as a result of the guarantee. These sales contain two types of guarantees for which VA pays net cash flow. VA guarantees that the principal

and interest payment due on a sold loan will be paid by the 15th of each month. If not paid by the borrower, VA allows the loan servicer to take funds from cash reserve accounts for the deficient amount. VA also guarantees the loan against loss at foreclosure. VA will not buy back the loans but will pay off the loan loss and foreclosure expenses. The subsidy rate for FY 2004 is 5.65 percent. For FY 2003 the subsidy rate was 5.06 percent. The liability for loan sale guarantees as of September 30, 2004 and 2003 is \$255 and \$77 million, respectively.

### Schedule for Reconciling Loan Sale Guarantee Liability Balances

<b>Beginning Balance, Changes and Ending Balance</b>	<b>FY 2004</b>	<b>FY 2003</b>
Beginning balance of the liability	\$ 77	\$ 210
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Interest subsidy costs	-	-
Default costs (net of recoveries)	19	14
Fees and other collections	-	-
Other subsidy costs	(2)	-
Total of the above subsidy expense components	17	14
Adjustments:		
Loan guarantee modifications	-	-
Fees received	-	-
Interest supplements paid	-	-
Foreclosed property and loans acquired	-	-
Claim payments to lenders	(36)	(19)
Interest accumulation on the liability balance	6	15
Other	9	16
Ending balance of the liability before reestimates	73	236
Subsidy reestimates by component		
Interest rate reestimate	102	(50)
Technical/default reestimate	80	(109)
Total of the above reestimate components	182	(159)
Ending balance of the liability	\$ 255	\$ 77

## Liability for Loan Guarantees (Post-1991)

VA reports the liability on the guarantee of loans, subject to Credit Reform requirements. For these loans, the guaranteed loan liability represents the present value of the estimated net cash flows to be paid by VA as a result of a defaulted loan guarantee. VA guarantees the loan against loss at foreclosure for which VA pays net cash flow up to

a legally specified maximum based on the value of individual loans. VA will pay the lender the guarantee and foreclosure expenses. If an agreement can be made with the veteran, VA may acquire the loan by refunding the lender for the loan. The FY 2004 and FY 2003 subsidy rate is 0.52 and 0.81 percent, respectively. The liability for loan guarantees as of September 30, 2004 and 2003 is \$4,485 and \$4,679 million, respectively.



## Schedule for Reconciling Loan Guarantee Liability Balances

<b>Beginning Balance, Changes and Ending Balance</b>	<b>FY 2004</b>	<b>FY 2003</b>
Beginning balance of the liability	\$ 4,679	\$ 5,452
Subsidy expense for guaranteed loans disbursed during the reporting years by component:		
Interest subsidy costs	-	-
Default costs (net of recoveries)	652	1,677
Fees and other collections	(469)	(1,145)
Other subsidy costs	-	-
Total of the above subsidy expense components	183	532
Adjustments:		
Loan guarantee modifications	-	-
Fees received	482	549
Interest supplements paid	-	-
Foreclosed property and loans acquired	67	189
Claim payments to lenders	(406)	(449)
Interest accumulation on the liability balance	263	284
Other	-	-
Ending balance of the liability before reestimates	5,268	6,557
Subsidy reestimates by component		
Interest rate reestimate	(241)	(471)
Technical/default reestimate	(542)	(1,407)
Total of the above reestimate components	(783)	(1,878)
Ending balance of the liability	\$ 4,485	\$ 4,679

## Estimation Technique Change

VA used the balances approach method for the 2004 financial statement reestimates to replace the traditional approach method used in FY 2003 to more accurately project the remaining financial requirements for cohorts being reestimated in the Direct Loan Financing Account (DLFA, 36X4127) and the Loan Sales Securities Account (LSSA, 36X4124). By comparing with the traditional method, the use of the balances approach results in a net difference of \$343.6 million less for all reestimated cohorts for the DLFA. The net difference for the LSSA is \$100.1 million more for all reestimated cohorts. As a result of the change of the calculator, future reestimates will be significantly less.

## Administrative Expense

Administrative expense on direct and guaranteed loans for the years ended September 30, 2004 and 2003, was \$154 and \$168 million, respectively.

## 8. Inventories

<b>Inventories as of September 30,</b>	<b>2004</b>	<b>2003</b>
Held for Current Sale	\$ 65	\$ 62
Other	4	11
<b>Total Inventories</b>	<b>\$ 69</b>	<b>\$ 73</b>

## 9. General Property, Plant and Equipment

Depreciation and amortization expense totaled \$805 and \$779 million in FY 2004 and FY 2003, respectively.

### General Property, Plant and Equipment as of September 30, 2004

	<b>Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>
Land and Improvements	\$ 303	\$ (13)	\$ 290
Buildings	14,915	(7,045)	7,870
Equipment	3,128	(1,884)	1,244
Other	1,974	(1,101)	873
Work in Progress	938	0	938
<b>Total Property, Plant, and Equipment</b>	<b>\$ 21,258</b>	<b>\$ (10,043)</b>	<b>\$ 11,215</b>

### General Property, Plant and Equipment as of September 30, 2003

	<b>Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>
Land and Improvements	\$ 285	\$ (10)	\$ 275
Buildings	14,507	(6,599)	7,908
Equipment	3,017	(1,789)	1,228
Other	1,797	(1,021)	776
Work in Progress	762	-	762
<b>Total Property, Plant, and Equipment</b>	<b>\$ 20,368</b>	<b>\$ (9,419)</b>	<b>\$ 10,949</b>

## 10. Liabilities Not Covered By Budgetary Resources

The total amount of VA liabilities not covered by budgetary resources was \$929.5 billion and \$959.6 billion as of September 30, 2004 and 2003, respectively, as shown in the following table.

### Components of Unfunded Liabilities as of September 30,

	2004	2003
Workers' Compensation*	\$ 2,112	\$ 2,239
Annual Leave	1,173	1,097
Judgment Fund	501	528
Environmental and Disposal	339	375
Accounts Payable – Canceled Appropriations	6	6
Veterans Compensation and Burial	924,800	954,800
Insurance	568	581
<b>Total</b>	<b>\$ 929,499</b>	<b>\$ 959,626</b>

\* The actuarial estimate for workers' compensation provided by DOL was computed using interest rates of 4.88 percent for FY 2004 and 3.84 percent for FY 2003.

## 11. Federal Employee and Veterans Benefits

### Federal Employee Benefits

#### Imputed Expenses-Employee Benefits years ended September 30,

	2004	2003
Civil Service Retirement System	\$ 366	\$ 351
Federal Employees Health Benefits	788	641
Federal Employees Group Life Insurance	2	2
<b>Total Imputed Expenses-Employee Benefits</b>	<b>\$ 1,156</b>	<b>\$ 994</b>

### Veterans Benefits

Certain veterans who die or are disabled from military service-related causes, as well as their dependents, receive compensation benefits. Also, veterans are provided with burial flags, headstones/markers, and grave liners for burial in a VA national cemetery or are provided a plot allowance for burial in a private cemetery. These benefits are provided in recognition of a veteran's military service and are recorded as a liability on the balance sheet.

### Federal Employee and Veterans Benefits Liabilities as of September 30,

	2004	2003
FECA	\$ 1,753	\$ 1,888
Compensation	921,500	951,600
Burial	3,300	3,200
<b>Total Federal Employee and Veterans Benefits Liabilities</b>	<b>\$ 926,553</b>	<b>\$ 956,688</b>

VA provides certain veterans and/or their dependents with pension benefits, based on annual eligibility reviews, if the veteran died or was disabled from non-service-related causes. The actuarial present value of the future liability for pension benefits is a non-exchange transaction and is not required to be recorded on the balance sheet. The projected amount of future payments for pension benefits (presented for informational purposes only) as of September 30, 2004 and 2003 was \$102.2 and \$102.7 billion, respectively.

### **Assumptions Used to Calculate the Veterans Benefits Liability**

Several significant actuarial assumptions were used in the valuation of compensation, pension, and burial benefits to calculate the present value of the liability. A liability was recognized for the projected benefit payments to: (1) those beneficiaries, including veterans and survivors, currently receiving benefit payments; (2) current veterans who will in the future become beneficiaries of the compensation and pension programs; and (3) a proportional share of those in active military service as of the valuation date who will become veterans in the future. Future benefits payments to survivors of those veterans in classes (1), (2), and (3) are also incorporated into the projection.

All future benefits were discounted. Discount rates were based on rates for securities issued by Treasury on September 30, 2004, ranging from 2 to 5.23 percent, and on September 30, 2003, ranging from 1.15 to 4.91 percent. Beginning in FY 2004, the discount rates used were based on U.S. Treasury's spot rates rather than corresponding constant maturity rates, which were used in previous years. Benefit payments were assumed to occur at the midpoint of the fiscal year.

All calculations were performed separately by attained age for the Compensation and Pension programs, while the Burial liability was calculated on an aggregate basis.

Life expectancies of beneficiaries collecting benefits from the Compensation and Pension programs were based upon studies of mortality experience of those beneficiaries between 1995 and 2003. Life expectancies of veterans not yet collecting these benefits used in the calculation of the liability for future beneficiaries are based on mortality derived from the 1990 U.S. decennial census and beneficiary mortality experience. Applying mortality improvements at a rate of 1 percent per annum brought both sets of mortality rates forward. In addition, rates of benefit termination of beneficiaries due to reasons other than mortality are also reflected.

The amount of benefits by category and age were based on current amounts being paid and future cost of living adjustments (COLAs) to determine the average benefits per veteran for each future time period. A COLA of 2.7 percent was assumed for FY 2005. For fiscal years after 2005, COLAs have been determined from OMB's estimates prepared in conjunction with the Administration's annual budget. Expected changes in benefits due to other reasons were also reflected.

Expected benefit payments have been explicitly modeled for the next 75 years. This period is the same as that used by the Office of the Actuary of the Social Security Administration. However, unlike Social Security, (1) estimates of expected benefit payments after this 75-year period were incorporated in the liability based on extrapolations reflecting expected aggregate experience by beneficiary category between the years 70 and 75 and (2) SSA uses an open population model, while the C&P projections only reflect benefits associated with military service through September 30, 2003.

## 12. Environmental and Disposal

VA had unfunded environmental and disposal liabilities in the amount of \$339 million and \$375 million as of September 30, 2004 and 2003, respectively. The majority of the unfunded liabilities involve asbestos removal, lead abatement, replacement of underground oil and gasoline tanks, decommissioning of waste incinerators, and decontamination of equipment prior to disposal.

While some facilities have applied prevailing state regulations that are more stringent than Federal guidelines, the Occupational Safety and Health Administration and Environmental Protection Agency regulations provide the legal base behind the majority of VA's environmental and disposal liabilities. Estimated liabilities for these projects are based on known contamination that exists today and have been computed by the facility engineering staff based on similar projects already completed, or by independent contractors providing work estimates.

## 13. Other Liabilities

Funded liabilities are generally considered to be current liabilities. Unfunded liabilities are generally considered to be non-current liabilities.

### Other Intragovernmental Funded Liabilities as of September 30,

	2004	2003
Deposit and Clearing Account Liabilities	\$ (61)	\$ (73)
Accrued Expenses - Federal	149	99
Deferred Revenue	283	446
Resources Payable to Treasury	350	404
Custodial Liabilities*	1,022	2,260
General Fund Receipts Liability	29	12
Accrued VA Contributions for Employee Benefits	3	2
<b>Total Other Intragovernmental Funded Liabilities</b>	<b>\$ 1,775</b>	<b>\$ 3,150</b>

\* The Custodial Liabilities Accounts include subsidy reestimates for loans made after September 30, 1991, which are subject to the provisions of the Credit Reform Act of 1990. The liability provision for future losses on credit reform guaranteed loans is comprised of a funded subsidy for each loan guaranteed at the rate equal to the amount of the present value of estimated loss to the Government for the cohorts of loans. The subsidy amount for each cohort is reestimated annually to ensure amounts reflect the actual losses on guaranteed loans. Based on the reestimated amounts, additional subsidy funds are provided for or excess funds are returned.

Other Intragovernmental Unfunded Liabilities  
as of September 30,

	2004	2003
Accrued FECA Liability	\$ 359	\$ 356
<b>Total Other Intragovernmental Unfunded Liabilities</b>	<b>\$ 359</b>	<b>\$ 356</b>

Other Public Funded Liabilities  
as of September 30,

	2004	2003
Accrued Funded Annual Leave	\$ 11	\$ 10
Accrued Expenses	2,482	2,135
Accrued Salaries and Benefits	583	420
Contract Holdbacks	12	16
Deferred Revenue	1	1
Unredeemed Coupons	1	1
Deposit and Clearing Account Liability	46	17
Unearned Premiums	111	118
Insurance Dividends Left on Deposit and Related Interest Payable*	1,677	1,673
Dividend Payable to Policyholders	225	254
Amounts due to non-federal trusts	1	0
Capital Lease Liability	30	33
<b>Total Other Public Funded Liabilities</b>	<b>\$ 5,180</b>	<b>\$ 4,678</b>

\* Interest earned on dividends left on deposit is paid annually to insurance policyholders on the policy anniversary dates.

Other Public Unfunded Liabilities  
as of September 30,

	2004	2003
Annual Leave*	\$ 1,172	\$ 1,097
Accounts Payable from Cancelled Appropriation	6	6
Amounts due to non-federal trust	188	0
Judgment Fund-Unfunded**	501	528
<b>Total Other Public Unfunded Liabilities</b>	<b>\$ 1,867</b>	<b>\$ 1,631</b>

\* Annual leave is accrued when earned and is adjusted at the end of the fiscal year to reflect current pay rates of cumulative leave earned but not taken. Sick and other types of leave are expensed as taken.

\*\* The Judgment Fund liability amount represents the estimate for future payments on legal cases that will be paid by the Treasury Judgment Fund on behalf of VA.

## 14. Leases

VA has both capital and operating leases. The capital lease liability is \$30 and \$33 million as of September 30, 2004 and 2003, respectively. Real property leases reflect those that VA has committed to as of September 30, 2004. Due to the number of equipment operating leases and the decentralization of records, the future commitment for equipment operating leases is not known. VA's FY 2004 operating lease costs were \$243 million for real property rentals and \$79 million for equipment rentals. The FY 2003 operating lease costs consisted of \$236 million for real property rentals and \$67 million for equipment rental. The following chart represents VA's operating lease commitments or costs for the next 5 years. Equipment amounts assume a range of 3.1 to 3.5 percent yearly increase in cost.

Leases:

YEAR	REAL PROPERTY	PERCENTAGE	EQUIPMENT
2005	\$ 237	3.1	\$ 82
2006	227	3.5	85
2007	212	3.4	88
2008	205	3.4	91
2009	188	3.4	94

## 15. Insurance Programs

Through VA, the United States Government administers five life insurance programs and the Veterans' Mortgage Life Insurance program for certain totally disabled veterans. VA supervises the Servicemembers' Group Life Insurance (SGLI) and the Veterans' Group Life Insurance (VGLI) programs, which provide life insurance coverage to members of the uniformed armed services, reservists, and post-Vietnam veterans. United States Code, Title 38, requires that the Life Insurance programs invest in Treasury securities.

### Administered Programs

The United States Government Life Insurance (USGLI) program was the Government's first venture into life insurance. During World War I, the U.S. provided Marine Insurance to protect the interests of ship owners and merchants who were providing supplies to the allies in Europe. USGLI was the natural outgrowth of this Marine Insurance. The program was established to meet the needs of World War I veterans, but remained open to servicemembers and veterans with service before October 8, 1940. The Government became a self-insurer because private insurance companies were unwilling to assume

the unpredictable risks associated with war. By establishing this program, Congress intended to avoid the financial burden imposed on the Government by the pension programs that were established after previous wars. The Government became the largest life insurer in the United States with the coverage provided by this program.

The National Service Life Insurance (NSLI) program covers policyholders who served during World War II. The program opened October 8, 1940, when it became clear that large-scale military inductions were imminent. Over 22 million policies were issued under the NSLI program. The majority of policies VA administers directly are NSLI policies. This program remained open until April 25, 1951, when two new programs were established for Korean War servicemembers and veterans.

The Veterans' Special Life Insurance (VSLI) program was established in 1951 to meet the insurance needs of veterans who served during the Korean Conflict, and the post-Korean period through January 1, 1957. During this period, all servicemembers on active duty were covered for \$10,000, at no cost, under a program known as Servicemen's Indemnity. They remained covered for 120

days after their discharge. The VSLI program allowed these newly discharged servicemembers to apply for \$10,000 of contract term insurance. Application had to be made during the 120-day period during which they remained covered by Servicemen's Indemnity. It was during this period that representatives of the commercial insurance industry began a major lobbying effort to get the Government out of the insurance business because the programs were viewed as competition. As a result, the VSLI program was closed to new issues at the end of 1956, and coverage for individuals in the uniformed services was terminated. Approximately 800,000 VSLI policies were issued between 1951 and 1957.

In addition to VSLI coverage, which was provided to healthy veterans, the Insurance Act of 1951 also established the Service-Disabled Veterans Insurance (S-DVI) program for veterans with service-connected disabilities. S-DVI is open to veterans separated from the service on or after April 25, 1951, who receive a service-connected disability rating. New policies are still being issued under this program.

In 1964, Congress enacted legislation providing for a limited reopening of NSLI and VSLI, and the Veterans' Reopened Insurance (VRI) program was established. Beginning May 1, 1965, veterans who had been eligible to obtain insurance between October 8, 1940, and January 1, 1957, could once again apply for government life insurance. They had one year to apply for this "reopened" insurance, which was available only to disabled veterans. Approximately 228,000 VRI policies were issued. No term insurance policies were issued in this program.

The Veterans' Mortgage Life Insurance (VMLI) program began in 1971, and is designed to provide financial protection to cover eligible veterans' home mortgages in the event of death. VMLI is issued to those severely disabled veterans who have received grants for specially adapted housing from VA. These grants are issued to veterans whose movement is substantially impaired because of their disability. The maximum amount of VMLI allowed an eligible veteran is \$90,000. The insur-

ance is payable if the veteran dies before the mortgage is paid off and is payable only to the mortgage lender.

## Supervised Insurance Programs

The Servicemembers' Group Life Insurance (SGLI) program was established in 1965 for Vietnam-era servicemembers. SGLI is supervised by VA and is administered by the Office of Servicemembers' Group Life Insurance (OSGLI) under terms of a group insurance contract. This program provides low-cost term insurance protection to servicemembers.

In 1974, the Veterans' Group Life Insurance (VGLI) program became available. VGLI, like SGLI, is supervised by VA, but is administered by the OSGLI. VGLI provides for the conversion of SGLI coverage to lifetime term insurance protection after a servicemember's separation from service.

## Public Insurance Carriers

VA supervises the administration of the SGLI and VGLI programs. Prudential Insurance Company of America (Prudential) provides insurance coverage directly for the SGLI and VGLI programs. VA has entered into a group policy with Prudential whereby Prudential and its reinsurers provide servicemembers and veterans coverage in multiples of \$10,000 up to a maximum of \$250,000. The basic SGLI coverage is provided to those members on active duty in the Army, Navy, Air Force, Marine Corps, Coast Guard, commissioned members of the Public Health Service and the National Oceanic and Atmospheric Administration. The Ready Reserve is also insured by SGLI, and includes reservists and members of the National Guard who are assigned to a unit or position in which they may be required to perform active duty or active duty for training. The VGLI coverage is comprised of separated and retired active duty members and reservists covered under Basic SGLI.

The Veterans' Opportunities Act of 2001 extended life insurance coverage to spouses and children of members insured under the SGLI program, effective November 1, 2001. For a spouse, up to \$100,000 of coverage can be purchased in increments of \$10,000, not to exceed the



amount of the servicemember's coverage. Each dependent child of every active duty servicemember or reservist insured under SGLI is automatically insured for \$10,000 free of charge.

Premiums for the SGLI and VGLI programs are set by mutual agreement between VA and Prudential. SGLI premiums for active duty personnel and their spouses are deducted from the servicemember's pay by the Armed Services components through the Department of Defense (DoD). DoD, through the Defense Finance and Accounting Service (DFAS), remits collected premiums to VA, which are then transmitted to Prudential. Prudential records the premiums and maintains investments in their accounting records separate and independent from the VA reporting entity. VA monitors Prudential's insurance reserve balances to determine their adequacy and may increase or decrease the amounts retained by Prudential for contingency purposes. The reserves for the contingent liabilities are recorded in Prudential's accounting records and are not reflected in the VA reporting entity, because the risk of loss on these programs is assumed by Prudential and its reinsurers through the terms and conditions of the group policy.

Effective January 1, 1970, the Secretary of Veterans Affairs determined the costs that are traceable to the

extra hazards of duty in the uniformed services, on the basis of the excess mortality incurred by members and former members of the uniformed armed services insured under SGLI, above what their mortality would have been under peacetime conditions. The Secretary is authorized to make adjustments regarding contributions from pay appropriations as may be indicated from actual experience.

## Reserve Liabilities

The insurance reserves for administered programs are reported as liabilities covered by budgetary resources, while part of the S-DVI and Veterans Insurance and Indemnities (VI&I) reserves are reported as liabilities not covered by budgetary resources. Reserves for SGLI and VGLI are maintained in Prudential's financial records since the risk of loss is assumed by Prudential. Actuarial reserve liabilities for the administered life insurance programs are based on the mortality and interest assumptions at time of issue. These assumptions vary by fund, type of policy, and type of benefit. The interest assumptions range from 2.25 to 5.0 percent. The mortality assumptions include the American Experience Table, the 1941 Commissioners Standard Ordinary (CSO) Table, the 1958 CSO Basic Table, and the 1980 CSO Basic Table.

### Insurance Liability (Reserve) Balances

Insurance Liability  
(Reserve) Balances  
As of September 30,  
2004

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	\$9,372	\$170	\$145	\$9,687
USGLI	30	5	-	35
VSLI	1,512	11	31	1,554
S-DVI	305	2	237	544
VRI	379	2	5	386
VI&I	85	-	-	85
Subtotal	\$11,683	\$190	\$418	\$12,291
Less Liability not Covered by Budgetary Resources				(568)
Liability Covered by Budgetary Resources				\$11,723

Insurance Liability  
(Reserve) Balances  
As of September 30,  
2003

Program	Insurance Death Benefits	Death Benefit Annuities	Disability Income & Waiver	Reserve Totals
NSLI	\$9,660	\$185	\$167	\$10,012
USGLI	34	5	-	39
VSLI	1,493	11	33	1,537
S-DVI	404	2	156	562
VRI	396	2	6	404
VI&I	86	-	-	86
Subtotal	\$12,073	\$205	\$362	\$12,640
Less Liability not Covered by Budgetary Resources				(581)
Liability Covered by Budgetary Resources				<u>\$12,059</u>

## Insurance In-Force

The amount of insurance in-force is the total face amount of life insurance coverage provided by each administered and supervised program as of the end of the fiscal year. It includes any paid-up additional coverage provided under these policies. Prudential and its reinsurers provided coverage to 5,946,231 and 5,901,345 insured for a face value of \$737.9 billion and \$725.8 billion as of September 30, 2004 and 2003, respectively. The face value of the insurance provided by Prudential and its reinsurers represents 97.5 and 97.4 percent of the total insurance in-force as of September 30, 2004 and 2003, respectively. The number of policies represents the number of active policies remaining in the program as of the end of each fiscal year.

	2004 Policies	2003 Policies	2004 Face Value	2003 Face Value
<b>Supervised Programs</b>				
SGLI Active Duty	1,545,000	1,548,000	\$371,135	\$372,659
SGLI Ready Reservists	783,500	775,500	176,493	174,171
SGLI Post Separation	120,000	87,000	28,351	20,512
SGLI Family - Spouse	990,000	990,000	97,198	96,215
SGLI Family - Children	2,100,000	2,100,000	21,000	21,000
VGLI	407,731	400,845	43,767	41,275
<b>Total Supervised</b>	<u>5,946,231</u>	<u>5,901,345</u>	<u>\$737,944</u>	<u>\$725,832</u>
<b>Administered Programs</b>				
NSLI	1,300,404	1,401,357	\$14,013	\$14,802
VSLI	213,545	220,719	2,525	2,566
S-DVI	165,651	154,537	1,614	1,484
VRI	57,757	62,696	523	556
USGLI	10,390	11,770	33	37
VMLI	2,625	2,793	170	176
<b>Total Administered</b>	<u>1,750,372</u>	<u>1,853,872</u>	<u>\$18,878</u>	<u>\$19,621</u>
<b>Total Supervised and Administered Programs</b>	<u>7,696,603</u>	<u>7,755,217</u>	<u>\$756,822</u>	<u>\$745,453</u>

## Policy Dividends

The Secretary of VA determines annually the excess funds available for dividend payment. Dividends are based on an actuarial analysis of the individual programs at the end of the preceding calendar year. Dividends are declared on a calendar year basis and paid on policy anniversary dates. Policyholders can elect to: (1) receive a cash payment; (2) prepay premiums; (3) repay loans; (4) purchase paid-up insurance; or (5) deposit the amount in an interest-bearing account. A provision for dividends is charged to operations, and an insurance dividend is established when gains to operations are realized in excess of those essential to maintain solvency of the insurance programs. Policy dividends for fiscal years 2004 and 2003 were \$497 and \$551 million, respectively.

## Sale of Prudential Stock

On December 18, 2001, Prudential completed its conversion from a mutual company to a stock company. As policyholder of the SGLI and VGLI programs, VA received 369,177 shares of Prudential stock. VA is liquidating these shares in six sales over a three-year period, which started in 2003. As of fiscal year end, VA has liquidated 246,000 shares of stock in four sales. Proceeds of \$9,824,505 from the sales have been deposited into the SGLI Contingency Reserve, which is held for VA by Prudential in an interest-bearing account. This guarantees that the monies will be used for the benefit of the servicemembers and veterans who are the intended recipients of these life insurance programs.

## 16. Contingencies

VA is a party in various administrative proceedings, legal actions, and tort claims arising from various sources including: disputes with contractors, challenges to compensation and education award decisions, loan guaranty indemnity debt cases, and allegations of medical malpractice. Certain legal matters to which VA may be a named party are administered and, in some instances, litigated by the Department of Justice. Generally, amounts (more than \$2,500 for Federal Tort Claims Act cases) to be paid under any decision, settlement, or award are funded from the Judgment Fund, which is maintained by Treasury. Of the amounts paid from the Judgment Fund, malpractice cases claimed 85 percent in FY 2004 and 84 percent in FY 2003. Contract dispute payments for FY 2004 and FY 2003 were \$9.4 and \$5.9 million, respectively.

VA uses accepted actuarial methods to estimate the liability resulting from medical malpractice and other tort claim

exposure. In FY 2004, VA discounted future estimated payments using U.S. Treasury spot rates as of September 30, 2004. Had these payments not been discounted, the associated liability would have been \$41 million more.

VA has recorded a liability for pending legal claims that are estimated to be paid by the Judgment Fund. This liability is established for all pending claims whether reimbursement is required or not. This liability was \$501 million for FY 2004 and \$528 million for FY 2003. There were 16 contract and personnel law cases with claimed amounts totaling \$117.8 million where there was at least a reasonable possibility that a loss may occur. VA is also required to record an operating expense and imputed financing source for the Judgment Fund's pending claims and settlements. Judgment Fund accounting is shown on the following page:

**Judgment Fund**

For the Years Ended September 30,

Fiscal Year Settlement Payments

Less Contract Dispute Payments

Imputed Financing-Paid by Other Entities

Increase (Decrease) in Liability for Claims

**Operating Expense (Revenue)**

	<b>2004</b>	<b>2003</b>
	\$ 108	\$ 92
	(11)	(6)
	97	86
	27	(97)
	\$ 70	\$ (11)

It is the opinion of VA's management that resolution of pending legal actions as of September 30, 2004 will not materially affect VA's operations or financial position when consideration is given to the availability of the Judgment Fund appropriation to pay some court-settled legal cases. Fiscal year 2004 settlement payments were \$97 million.

The amount of unobligated and obligated authority relating to appropriations cancelled on September 30, 2004 and 2003 was \$16.9 million and \$20.5 million, respectively. Any payments due that may arise relating to cancelled appropriations will be paid out of the current year's appropriations in accordance with the provisions of the Expired Funds Control Act of 1990.

VA provides medical care to veterans on an "as available" basis, subject to the limits of the annual appropriations. In accordance with 38 CFR 17.36 (c), VA's Secretary makes an annual enrollment decision that defines the veterans, by priority, who will be treated for that fiscal year subject to change based on funds appropriated, estimated collections, usage, the severity index of enrolled veterans, and changes in cost. While VA expects to continue to provide medical care to veterans in future years, an estimate of this amount cannot be reasonably made. Accordingly, VA recognizes the medical care expenses in the period the medical care services are provided. For the fiscal years 2000-2004, the average medical care cost per year was \$22 billion.

## 17. Exchange Transactions

### Exchange Revenues

Although VA recognizes full cost per SFFAS No. 4, VHA has legislated exceptions to the requirement to recover the full cost to the Federal Government of providing services, resources, or goods for sale. Under "enhanced sharing authority," VHA facilities may enter into arrangements that are in the best interest of the Federal Government. In FY 2004, randomly selected VA medical centers were reviewed by the Financial and Systems Quality Assurance Service to determine the facility's compliance with Statement of Federal Financial Accounting Standards No. 7 and the Chief Financial Officers Act of 1990.

VA's Loan Guaranty Program collects rental fees on a small number of properties during the period when the property is titled to VA.

NCA leases lodges at 11 cemeteries to not-for-profit groups for no fee. The not-for-profit groups are required to provide the upkeep on the lodges and pay the costs for utilities, insurance, minor repairs, and maintenance and any other costs associated with the lodges, and NCA pays for major repairs at these facilities. NCA also has four agricultural leases with private companies/individuals.

NCA leases land for growing crops and, on certain leases, receives various services in exchange from the lessee, such as brush cutting and removal services, backfilling and grading of roads, and welding services. In addition, NCA received fees for motion picture filming performed at three cemeteries.

## Exchange Transactions with Public

Exchange transactions with the public occur when prices are set by law or executive order and are not based on full cost or on market price. VA's Medical Care Collections Fund, "Conforming Amendments," changed the language of specific sections of 38 USC Chapter 17 to substitute "reasonable charges" for "reasonable cost." The VHA Chief Financial Officer (CFO) is responsible for implementing and maintaining these reasonable charges for billing third-party payers for services provided to insured veterans for treatment of nonservice-connected conditions.

Reasonable charges are used to bill for reimbursable health insurance, non-Federal workers' compensation, and no-fault or uninsured motorists insurance cases.

Reasonable charges are based on provider charges in the market area of each VA facility. The lesser of VA-billed charges or their usual customary and reasonable payment to other providers will be paid.

Cost-based per diems are calculated annually to produce tort rates used to bill for tort fees or workers' compensation (other than Federal), humanitarian emergency, ineligible patient, VA employee, family member, allied beneficiary, no fault or uninsured motorist's insurance, or reimbursable insurance cases. These per diem costs are derived primarily from cost and workload data from a national cost allocation report (Cost Distribution Report).

VA is required to collect a co-payment of \$7 from veterans for treatment of a nonservice-related condition for each 30-day supply of medication furnished on an outpatient basis. This fee does not cover the cost of the medications in the vast majority of cases.

VA's Loan Guaranty Program collects certain fees that are set by law. The loan guarantee funding fees collected for FY 2004 were \$478.9 million and for FY 2003 were \$634 million. The loan guarantee lender participation fees collected for FY 2004 and FY 2003 were both \$1.9 million.

## Intragovernmental Exchange Transactions

This section discloses intragovernmental exchange transactions in which VA provides goods or services at a price less than the full cost, or does not charge a price at all, with explanations for disparities between the billing and full cost.

VA and the Department of Defense (DoD) have authority to enter into agreements and contracts for the mutual use or exchange of use of hospital and domiciliary facilities and other resources. The providing agency shall be reimbursed for the cost of the health care resources based on the methodology agreed to by VA and DoD. Facility directors have the flexibility to consider local conditions and needs and the actual costs of providing the services. VA's General Counsel has determined that full cost recovery is not mandated. VHA captures the total amount of reimbursements received under DoD sharing agreements, but the total amount billed below full cost is not readily available. VHA is in the process of developing mechanisms to report this information in the future. VBA collects funding from DoD in order to administer certain education programs. DoD transferred \$280.1 million during FY 2004 for the Post-Vietnam Era Education Assistance Program, Reinstated Entitlements Program for Survivors, and the New GI Bill for Veterans.

When VA furnishes medical care or services for beneficiaries of other Federal agencies, and that care or service is not covered by an applicable local sharing agreement, the billing rates used are determined and published annually by the VHA CFO. Similar to the tort rates, interagency billing rates are determined from cost and workload data in the Cost Distribution Report.

## 18. Net Cost of Veterans Affairs Programs

All of VA's net program costs are part of the 700 budget functional classification (Veterans Benefits and Services).

Schedule of Net Program Cost

For the Year Ended September 30, 2004 (Dollars in Millions)	Medical Care	Medical Education	Medical Research	Compensation	Pension	Education	Vocational Rehab	Loan Guaranty	Insurance	Burial	Non-Program	Total
<b>Production Costs</b>												
<b>Intragovernmental Costs</b>	\$ 1,310	\$ 6	\$ 22	\$ 54	\$ 5	\$ 3	\$ 3	\$ 4	\$ 31	\$ 16	\$ 97	\$ 1,551
<b>Less Earned Revenues</b>	(73)	-	(25)	-	(7)	(272)	-	(1,047)	(893)	-	(1,363)	(3,680)
<b>Net Intragovernmental Production Costs</b>	1,237	6	(3)	54	(2)	(269)	3	(1,043)	(862)	16	(1,266)	(2,129)
<b>Public Costs</b>	26,460	1,105	912	(2,848)	3,528	2,518	673	2,263	1,529	416	2,086	38,642
<b>Less Earned Revenues</b>	(2,301)	-	(11)	-	-	(212)	-	(79)	(604)	-	(39)	(3,246)
<b>Net Public Production Costs</b>	24,159	1,105	901	(2,848)	3,528	2,306	673	2,184	925	416	2,047	35,396
<b>Non-Production Costs</b>	-	-	-	-	-	-	-	-	-	-	-	-
<b>Hazardous Waste Clean-up</b>	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total Net Cost of Operations</b>	\$ 25,396	\$ 1,111	\$ 898	\$ (2,794)	\$3,526	\$2,037	\$676	\$1,141	\$63	\$432	\$781	\$33,267

## Schedule of Net Program Cost

For the Year Ended September 30, 2003 (Dollars in Millions)	Medical Care	Medical Education	Medical Research	Compensation	Pension	Education	Vocational Rehab	Loan Guaranty	Insurance	Burial	Non-Program	Total
<b>Production Costs</b>												
<b>Intragovernmental Costs</b>	\$ 3,542	\$ 30	\$ 76	\$ 139	\$ 9	\$ 8	\$ 6	\$ 816	\$ 43	\$ 56	\$ 170	\$ 4,895
<b>Less Earned Revenues Net</b>	(61)		(35)		(7)	(256)		(706)	(949)		(1,029)	(3,043)
<b>Intragovernmental Production Costs</b>	3,481	30	41	139	2	(248)	6	110	(906)	56	(859)	1,852
<b>Public Costs</b>	21,583	1,006	795	131,207	3,489	2,209	643	(991)	1,642	69	1,488	163,140
<b>Less Earned Revenues Net Public</b>	(1,592)		(10)			(221)		(107)	(645)		(47)	(2,622)
<b>Production Costs</b>	19,991	1,006	785	131,207	3,489	1,988	643	(1098)	997	69	1,441	160,518
<b>Non-Production Costs</b>												
<b>Hazardous Waste Clean-up</b>	104											104
<b>Total Net Cost of Operations</b>	\$ 23,576	\$ 1,036	\$ 826	\$ 131,346	\$ 3,491	\$ 1,740	\$ 649	\$ (988)	\$ 91	\$ 125	\$ 582	\$ 162,474

## 19. Disclosures Related to the Statements of Budgetary Resources

Apportionment categories of obligations incurred

Obligations

Years Ended September 30,

Category A, Direct

Category B, Direct

Reimbursable

Exempt from Apportionment

**Total Obligations**

	<b>2004</b>	<b>2003</b>
Category A, Direct	\$ 31,972	\$ 29,252
Category B, Direct	37,398	34,432
Reimbursable	4,657	4,434
Exempt from Apportionment	394	1,231
<b>Total Obligations</b>	<b>\$ 74,421</b>	<b>\$ 69,349</b>

## Borrowing Authority

Loan Guaranty had borrowing authority of \$1.1 billion and \$1.3 billion as of September 30, 2004 and 2003, respectively.

The Vocational Rehabilitation Program had borrowing authority of \$4.1 and \$3.5 million as of September 30, 2004 and 2003, for making direct loans. Loan Guaranty borrowing is repaid to Treasury through the proceeds of portfolio loan collections, funding fees, and the sale of loans to

Vinnie MAC trusts. The Vocational Rehabilitation loans generally had duration of 1 year, and repayment was made from offsetting collections.

## Adjustments to Budgetary Resources

During the reporting period, adjustments to budgetary resources available at the beginning of the year included VA appropriations that were subjected to a rescission



that totaled \$443 million. Additionally, unobligated balances of prior year recoveries of \$270 million were rescinded. Various VA program accounts received a cut in discretionary budget authority.

## Permanent Indefinite Appropriations

VA has three permanent and indefinite appropriations. The Veterans Housing Benefit Program Fund covers all estimated subsidy costs arising from post-1991 loan obligations for veterans housing benefits. The Fund's objective is to encourage and facilitate the extension of favorable credit terms by private lenders to veterans for the purchase, construction, or improvement of homes to be occupied by veterans and their families. The Loan Guarantee Revolving Fund is a liquidating account that contains all of VA's pre-credit reform direct and guaranteed loans. It also holds fund balances received from reimbursements from financing accounts for loan modifications and rentals of foreclosed properties not yet transferred to financing accounts. The Native American Direct Loan Account was established to cover all subsidy costs arising from direct loan obligations related to a veteran's purchase, construction, or renovation of a dwelling on trust land.

## Use of Unobligated Balances of Budget Authority

Available unobligated balances on the Statement of Budgetary Resources are composed of current fiscal year apportioned funds for annual, multi-year, and no-year appropriations from Congress as well as revolving and trust funds. Other balances not available are composed of expired appropriation unobligated amounts, which generally are not available for new obligations,

but can be used to increase existing obligations under certain circumstances. This amount also includes unobligated funds that were not apportioned by OMB for FY 2004 use.

Unobligated VA funds are available for uses defined in VA's FY 2004 Appropriation Law (P.L. 108-199). These purposes include veterans medical care, research, education, construction and maintenance of VA buildings, veterans and dependents benefits, veterans life insurance, loan guaranty programs, veterans burial benefits, and administrative functions. Various obligation limitations are imposed on individual VA appropriations. Examples include travel obligation limitations and limitation of the use of medical care multi-year funds to object classes for equipment, structures, and land.

## Explanation of Differences Between Statement of Budgetary Resources and the Budget

As a result of an analysis of aged obligations, obligations were reduced by \$90 million on the Statements of Budgetary Resources for both FY 2004 and FY 2003. These adjustments were not reflected in the FACTS II data used to prepare the President's Budget. No other differences were identified as of the preparation date of the financial statements.

## Contributed Capital

The amount of contributed capital received during FY 2004 consisted of donations in the amount of \$40.5 million to the General Post Fund and \$0.1 million to the National Cemetery Gift Fund.



## 20. Disclosures Related to the Statements of Financing

The Statement of Financing section “Costs That Do Not Require Resources in the Current Period” includes only the fiscal year increases in liabilities not covered by budgetary resources. For existing liabilities, there will

always be a difference between this section and the value of liabilities not covered by budgetary resources disclosed in Note 10 and included in the liabilities section of the Balance Sheet.

## 21. Dedicated Collections

In the Federal Government, dedicated collections are accounted for in trust funds and special funds. The term “trust funds” as used in this report and in Federal budget accounting is frequently misunderstood. In the private sector, “trust” refers to funds of one party held by a second party (the trustee) in a fiduciary capacity. In the Federal budget, the term “trust fund” means only that the law requires that funds be accounted for separately and used only for specified purposes and that the account be designated as a “trust fund.”

A change in law may change the future receipts and the terms under which the fund’s resources are spent. The “trust fund assets” represent all sources of receipts and amounts due the trust fund regardless of source. This includes “related governmental transactions,” which are transactions between two different entities within the Federal Government. The “Investments with Treasury” assets are comprised of

investments in Federal debt securities and related accrued interest. These securities will require redemption if a fund’s disbursements exceed its receipts. Unless specifically provided for by law, trust funds may only place excess funds in Federally backed investments (e.g., Federal debt securities).

The table below summarizes the name, type, and purpose of the funds within VA that receive dedicated collections. All of the funds listed use the accrual basis of accounting. However, collections are reported as actually received in accordance with OMB Circular A-34. The insurance funds listed also adhere to the requirements of FASB No. 120, “Accounting and Reporting by Mutual Life Insurance Enterprise,” and issue a separate annual report. All of the funds generally receive authority to use current year contributions as well as a portion of previously contributed amounts.

Fund Name	Fund Type	Treasury Symbol	Authority	Purpose of Fund	Financing Sources
<b>Medical Care Collections Fund</b>	Special	36x5287	P.L. 105-33 111 Stat 665	Accumulates recoveries from third parties and patient co-payments.	Public, primarily insurance carriers.
<b>Health Service Improvement Fund</b>	Special	36x5358	P.L 106-117 113 Stat 1561	Accumulates recoveries from enhanced use leases and patient co-payments.	Public.
<b>Escrowed Funds for Shared Medical Equipment Purchases</b>	Deposit	36x6019	106 Stat 1974	Receives payments from public companies involved in joint purchases of medical equipment.	Public, universities, pharmaceuticals & other medical organizations.
<b>Personal Funds of Patients</b>	Deposit	36x6020	38 U.S.C. 3204	Temporarily holds funds.	Public, patients.
<b>Employee Allotments for Savings Bonds</b>	Deposit	36x6050	31 U.S.C. 3105	Temporarily holds funds.	Employees.
<b>Cemetery Gift Fund</b>	Trust	36x8129	38 U.S.C. 1007	Receives donations for veteran cemeteries.	Public donors.
<b>National Service Life Insurance Fund</b>	Trust	36x8132	38 U.S.C. 720	Accumulates premiums to insure veterans of WWII.	Public, veterans.
<b>Post-Vietnam Era Education Assistance Program</b>	Trust	36x8133	38 U.S.C. 1622	Subsidizes the cost of education to veterans.	Veterans, DoD.
<b>U.S. Government Life Insurance</b>	Trust	36x8150	38 U.S.C. 755	Premiums insure WWI veterans.	Public, veterans.
<b>Veterans Special Life Insurance Fund</b>	Trust	36x8455	38 U.S.C. 723 101-228	Premiums insure Korean conflict veterans without Service-related disabilities.	Public, veterans.
<b>General Post Fund, National Homes</b>	Trust	36x8180	38 U.S.C. 101-228	Receives restricted and unrestricted use donations	Public, mostly veterans.

The following tables provide condensed information on assets, liabilities, fund balances, net costs, and changes in fund balances:

For the year ended September 30, 2004

Fund Symbol

**Assets:**

	5287	5358	6020	8132	8133	8150	8455	8180	Total
Fund balance with Treasury	\$ 155	\$ -	\$ 45	\$ 10	\$ 75	\$ -	\$ 1	\$ -	\$ 286
Investments with Treasury	-	-	-	11,121	-	51	1,923	68	13,163
Other Assets	555	5	-	545	1	2	109	18	1,235
<b>Total Assets</b>	710	5	45	11,676	76	53	2,033	86	14,684
<b>Liabilities:</b>									
Payables to Beneficiaries	-	-	-	142	1	1	10	-	154
Other Liabilities	-	-	45	11,251	-	50	1,955	2	13,303
<b>Total Liabilities</b>	-	-	45	11,393	1	51	1,965	2	13,457
<b>Net Position:</b>									
Cumulative Results	710	5	-	283	75	2	68	84	1,227
<b>Total Liabilities &amp; Net Position</b>	\$ 710	\$ 5	\$ 45	\$ 11,676	\$ 76	\$ 53	\$ 2,033	\$ 86	\$ 14,684

For the year ended September 30, 2004

Fund Symbol

**Revenues:**

	5287	5358	8132	8133	8150	8455	8180	Total
Exchange - Federal	\$ (24)	\$ -	\$ 718	\$ -	\$ 3	\$ 141	\$ -	\$ 838
Exchange - Public	2,006	(114)	466	1	-	72	2	2,433
Non-Exchange - Federal	-	-	-	-	-	-	-	-
Non-Exchange - Public	-	-	-	-	-	-	-	-
<b>Total Revenues</b>	1,982	(114)	1,184	1	3	213	2	3,271
<b>Expenses:</b>								
Program Expenses	212	(19)	1,211	4	4	215	40	1,667
<b>Total Expenses</b>	212	(19)	1,211	4	4	215	40	1,667
<b>Net Change from Operations</b>								
Beginning Net Position	568	132	309	77	2	69	80	1,237
Total Financing Sources	(1,628)	(31)	1	-	-	-	42	(1,616)
Change in Accounting Policy	-	-	-	-	-	-	-	-
Net Cost of Operations	1,770	(96)	(27)	(2)	-	(1)	(38)	1,606
<b>Ending Equity</b>	\$ 710	\$ 5	\$ 283	\$ 75	\$ 2	\$ 68	\$ 84	\$ 1,227

# Required Supplementary Stewardship Information (Unaudited)

*These materials are not audited.*

## 1. Heritage Assets

Heritage assets are properties that possess one or more of the following characteristics: historical or natural significance; cultural; educational or aesthetic value; or significant architectural characteristics. The monetary value of heritage assets is often not estimable or relevant. By nature they are expected to be maintained in perpetuity. VA has properties at medical centers and national cemeteries that meet the criteria for a heritage asset. During the reporting period, all maintenance

expenses were recorded as incurred. Heritage assets are reported in terms of physical units. Generally, additions to VA's Heritage Asset inventory result from field station surveys, which identify items such as new collections or newly designated assets. Items are generally donated or existing VA assets are designated as heritage. Most are used for mission purpose and maintained in working order. Remaining items are mothballed.

### Heritage Assets in Units

#### As of September 30,

	2004	2003
Art Collections	33	30
Buildings and Structures	1,817	1,815
Monuments/Historic Flag Poles	724	969
Other Non-Structure Items	76	71
Archaeological	11	11
Cemeteries	157	157
<b>Total Heritage Assets in Units</b>	<b>2,818</b>	<b>3,053</b>

## 2. Non-Federal Physical Property

Annually, VA provides funding to state governments for the purchase, construction, or major renovation of physical property owned by the state. In most cases these grant programs involve matching funds from the states.

### Grant Program Costs

#### Years Ended September 30,

	2004	2003
State Extended Care Facilities	\$ 66	\$ 121
State Veterans Cemeteries	34	30
<b>Total Grant Program Costs</b>	<b>\$ 100</b>	<b>\$ 151</b>

The Extended Care Facilities Grant Program assists states in acquiring facilities to provide domiciliary, nursing home, and other day health care for veterans, and to expand, remodel, or alter existing buildings to provide domiciliary, nursing home, hospital, and day health care for veterans in state homes. VA participates in two grant-in-aid programs for states. VA may participate in up to 65 percent of the cost of construction or acquisition of state nursing homes or domiciliaries or in renovations of existing state homes. Over the last five fiscal years, the State Home Construction Grant Program

has awarded grants in excess of \$424 million. VA also provides per diem payment for the care of eligible veterans in state homes.

Since the cemetery program was established in 1980, VA has awarded grants totaling more than \$208.6 million to 33 states and the Commonwealths of Guam and the Northern Marianas. The program provides up to 100 percent of the cost to establish, expand, or improve state veterans' cemeteries. States provide the land and agree to operate the cemeteries.

### 3. Human Capital

Investment in human capital comprises those expenses for education and training programs for the general public that are intended to increase or maintain national economic productive capacity. It does not include expenses for internal Federal education and training of civilian employees.

#### **Veterans and Dependents Education Years ended September 30,**

##### **Program Expenses**

Education and Training-Dependents of Veterans

	2004	2003
Education and Training-Dependents of Veterans	\$ 320	\$ 266
Vocational Rehabilitation and Education Assistance	2,517	2,309
Administrative Program Costs	230	288
<b>Total Program Expenses</b>	<b>\$ 3,067</b>	<b>\$ 2,863</b>

Vocational Rehabilitation and Education Assistance

Administrative Program Costs

##### **Total Program Expenses**

##### **Program Outputs (Participants)**

Dependent Education

67,420 64,582

Veterans Rehabilitation

75,409 71,549

Veterans Education

409,695 400,289

#### **Program Outcomes**

VA's education and training programs are intended to provide higher education to dependents who might not be able to participate otherwise. Veterans rehabilitation and employment programs are provided to service-disabled veterans; they are designed to improve employability and promote independence for the disabled. Educational programs for active duty personnel, reservists, and veterans provide higher education assistance to those who are eligible under the MGI B and the Veterans Educational Assistance Program. Education and training assistance are

provided to dependents of veterans who died of service-connected disability or whose service-connected disability was rated permanent and total. The Vocational Rehabilitation and Employment program is open to veterans who have a 10 percent or greater service-connected disability rating and are found to have a serious employment handicap. The program provides evaluation services, counseling, and training necessary to assist them in becoming employable and maintaining employment to the extent possible. The Veterans Education program provides educational assistance to eligible servicemembers and veterans.

## 4. Health Professions Education

### Health Professions Education

Years Ended September 30,

2004

2003

#### Program Expenses

Physician Residents and Fellows	\$ 420	\$ 404
Associated Health Residents and Students	62	60
Instructional and Administrative Support	401	367
<b>Total Program Expenses</b>	<b>\$ 883</b>	<b>\$ 831</b>

#### Program Outputs

Health Professions Rotating Through VA:

Physician Residents and Fellows	29,179	28,000
Medical Students	16,740	16,000
Nursing Students	20,275	17,000
Associated Health Residents and Students	16,921	15,000
<b>Total Program Outcomes</b>	<b>83,115</b>	<b>76,000</b>

### Program Outcomes

VA's education mission contributes to high-quality health care for veterans by providing a climate of scientific inquiry between trainees and teachers; application of medical advances more readily through an academic setting; supervised trainees who provide clinical care; and educational programs that enable VA to recruit highly qualified health care professionals.

The Veterans Health Administration (VHA) conducts education and training programs to enhance the quality of care provided to veterans within the VA health care system. Building on the long-standing, close relationships among VA and the Nation's academic institutions, VA plays a leadership role in defining the

education of future health care professionals that helps meet the changing needs of the Nation's health care delivery system. Title 38 U.S.C. mandates that VA assist in the training of health professionals for its own needs and those of the Nation. Through its partnerships with affiliated academic institutions, VA conducts the largest education and training effort for health professionals in the Nation. Each year, over 83,000 medical and other students receive some or all of their clinical training in VA facilities through affiliations with over 1,200 educational institutions including 107 medical schools. Many have their health profession degrees and contribute substantially to VA's ability to deliver cost-effective and high-quality patient care during their advanced clinical training at the VA.

## 5. Research and Development

Investments in research and development comprise those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other benefits.

**Program Expense  
Year ended September 30,**

Program Expense						2004		
Year ended September 30,		Basic	Applied	Development		Total		
Medical Research Service	\$	172.9	\$	81.8	\$	-	\$	254.7
Rehabilitative Research and Development		3.5		27.9		17.0		48.4
Health Services Research and Development		-		61.8		-		61.8
Cooperative Studies Research Service		-		27.7		-		27.7
Medical Research Support		-		452.0		-		452.0
Prosthetic Research Support		-		4.8		-		4.8
<b>Total Program Expenses</b>	\$	176.4	\$	656.0	\$	17.0	\$	849.4

**Program Expense  
Year ended September 30,**

Program Expense					2003
Year ended September 30,	Basic	Applied	Development		Total
Medical Research Service	\$ 141	\$ 80.7	\$ -	\$	221.7
Rehabilitative Research and Development	3.1	27.5	20.3		50.9
Health Services Research and Development	-	61.5	-		61.5
Cooperative Studies Research Service	-	27.0	-		27.0
Medical Research Support	-	402.9	-		402.9
Prosthetic Research Support	-	4.7	-		4.7
<b>Total Program Expenses</b>	<b>\$ 144.1</b>	<b>\$ 604.3</b>	<b>\$ 20.3</b>	<b>\$</b>	<b>768.7</b>

In addition, VHA researchers received \$459 million in grants from the National Institutes of Health and \$252 million in other grants during FY 2004. These grants went directly to researchers and are not considered part of the VA entity. They are being disclosed here but are not accounted for in the financial statements.

## Program Outcomes

For FY 2004, VA's R&D general goal for stewardship was to ensure that VA medical research programs met the needs of the veteran population and contributed to the Nation's knowledge about disease and disability. Target levels were established for the: (1) percent of funded research projects relevant to VA's health-care mission in designated

research areas and (2) number of research and development projects. Strategies were developed in order to ensure that performance targets would be achieved.

VA's Medical Research Program goal is to be the premier research organization, leading our Nation's efforts to discover knowledge and create innovations that promote and advance the health and care of veterans and the Nation. To achieve this goal, VA targets research projects that address special needs of veteran patients and balance research resources among basic and applied research, in order to ensure a complementary role between the discovery of new knowledge and the application of these discoveries to medical practice.

**Research and Development Measures-Actual  
Year ended September 30,**

Percent of Funded Research Projects Relevant to VA's

	<b>2004</b>	<b>2003</b>
Health-Care Mission	97.1%	95.6%
Number of Research and Development Projects	2,165	2,075

# Required Supplementary Information (Unaudited)

*These materials are not audited.*

## 1. Deferred Maintenance

Deferred maintenance is classified as not performed when it should have been or as scheduled but delayed to a future period. It is VA policy to ensure that medical equipment and critical facility equipment systems are maintained and managed in a safe and effective manner; therefore, deferred maintenance is not applicable to them.

VA facilities reported their cost estimates for deferred maintenance by utilizing either the Condition Assessment Survey or the Total Life-Cycle Cost Method.

### Deferred Maintenance as of September 30,

	2004	2003
General PP&E	\$ 1,649	\$ 1,433
Heritage Assets	34	30
<b>Total Deferred Maintenance</b>	<b>\$ 1,683</b>	<b>\$ 1,463</b>

### Balances with Other Federal Entities

#### Intragovernmental Assets as of September 30, 2004

Trading Partners	Fund Balance with Treasury	Investments	Accounts Receivable	Other Assets
Treasury	\$ 16,741	\$ 13,643	\$ -	\$ 8
DoD - Defense Agencies			64	
All Other			68	114
<b>Total Intragovernmental Assets</b>	<b>\$ 16,741</b>	<b>\$ 13,643</b>	<b>\$ 132</b>	<b>\$ 122</b>

#### Intragovernmental Liabilities as of September 30, 2004

Trading Partners	Accounts Payable	Debt	Other
Treasury	\$ 46	\$ 2,618	\$ 1,311
Other	26		823
<b>Total Intragovernmental Liabilities</b>	<b>\$ 72</b>	<b>\$ 2,618</b>	<b>\$ 2,134</b>



**Intragovernmental Earned Revenue and Related Cost (trade activity)****Year Ended September 30, 2004**

<b>Trading Partner</b>	<b>Earned Revenue</b>
DoD - Defense Agencies	\$ 830
Health & Human Services	132
Justice	101
All Other	676
<b>Total Earned Revenue</b>	<u>\$ 1,739</u>
<b>Related Cost</b>	<u>\$ 1,551</u>

**Intragovernmental Non-Exchange Revenue****Year Ended September 30, 2004**

<b>Trading Partner</b>	<b>Transfers-Out</b>
Treasury	\$ 1,941

**Schedule of Budgetary Activity  
Year Ended September 30, 2004**

	<b>Total Budgetary Resources</b>	<b>Obligations Incurred</b>	<b>Spending Authority from Offsetting Collections and Adjustments</b>	<b>Obligated Balance net, Oct 1</b>	<b>Obligated Balance net, Sept. 30</b>	<b>Total Outlays</b>
<b>VHA</b>						
0152 Medical Admin	4,123	4,086	23	13	656	3,420
0160 Medical Care	22,855	21,112	282	3,351	2,311	21,870
0161 Medical & Prosthetic Research	501	434	41	119	123	389
0162 Medical Facilities	3,201	3,142	11	-	658	2,473
All Other	1,268	907	289	636	827	427
<b>Total</b>	<b>31,948</b>	<b>29,681</b>	<b>646</b>	<b>4,119</b>	<b>4,575</b>	<b>28,579</b>
<b>VBA</b>						
0102 Compensation, Pension, & Burial Benefits	31,020	29,959	-	2,267	2,441	29,785
0137 Readjustment Benefits	3,212	2,965	272	72	82	2,683
4025 Housing Credit Liquidating	60	32	100	(23)	2	(93)
4127 Direct Loan Financing	773	571	781	78	71	(203)
4129 Guaranteed Loan Financing	7,524	3,330	1,811	20	22	1,517
8132 National Service Life Insurance Fund	11,093	1,603	365	1,461	1,468	1,231
All Other	4,039	1,847	1,249	399	418	579
<b>Total</b>	<b>57,721</b>	<b>40,307</b>	<b>4,578</b>	<b>4,274</b>	<b>4,504</b>	<b>35,499</b>
<b>NCA</b>						
0129 National Cemetery Adm.	149	144	-	25	33	136
All Other	38	34	-	36	31	39
<b>Total</b>	<b>187</b>	<b>178</b>	<b>-</b>	<b>61</b>	<b>64</b>	<b>175</b>
<b>ADM</b>						
0151 General Operating Expenses	1,945	1,851	530	244	308	1,257
All Other	2,763	2,404	2,145	323	676	(94)
<b>Total</b>	<b>4,708</b>	<b>4,255</b>	<b>2,675</b>	<b>567</b>	<b>984</b>	<b>1,163</b>
<b>Total of all Business Lines</b>	<b>94,564</b>	<b>74,421</b>	<b>7,899</b>	<b>9,021</b>	<b>10,127</b>	<b>65,416</b>

## Segment Information

<b>Condensed Balance Sheet as of September 30</b>	<b>Supply Fund</b>		<b>Enterprise Fund</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
<b>Assets</b>				
Fund Balance with Treasury	\$ 921	\$ 775	\$ 96	\$ 90
Accounts Receivable, Net	133	220	28	28
General Property, Plant and Equipment	4	5	22	24
Other Assets Including Inventory	27	25	6	8
<b>Total Assets</b>	<b>\$ 1,085</b>	<b>\$ 1,025</b>	<b>\$ 152</b>	<b>\$ 150</b>
<b>Liabilities and Net Position</b>				
Accounts Payable	\$ 67	\$ 49	\$ 4	\$ 8
Deferred Revenues	338	438	-	-
Other Liabilities	524	380	57	34
<b>Total Liabilities</b>	<b>929</b>	<b>867</b>	<b>61</b>	<b>42</b>
Cumulative Results of Operations	156	158	91	108
<b>Total Liabilities and Net Position</b>	<b>\$ 1,085</b>	<b>\$ 1,025</b>	<b>\$ 152</b>	<b>\$ 150</b>
<b>Condensed Net Cost Information</b>				
<b>Total Program Costs</b>	<b>\$ 1,829</b>	<b>\$ 1,375</b>	<b>\$ 230</b>	<b>\$ 188</b>
<b>Earned Revenues</b>				
Intra-Departmental	(573)	(448)	(143)	(185)
Other Federal Entities	(1,225)	(911)	(66)	(29)
Non-Federal	(27)	(36)	-	-
<b>Total Earned Revenues</b>	<b>\$ (1,825)</b>	<b>\$ (1,395)</b>	<b>\$ (209)</b>	<b>\$ (214)</b>
<b>Net Program Costs</b>	<b>\$ 4</b>	<b>\$ (20)</b>	<b>\$ 21</b>	<b>\$ (26)</b>

## 2. Enterprise Fund Services

VA was approved by OMB in May 1996 as one of six pilot franchise fund agencies operating within the Executive Branch of Government. VA's Franchise Fund was established as a revolving fund and began operations in FY 1997. By law, the business lines within the Fund can only sell to Federal entities on a fee-for-service basis.

The VA Franchise Fund supports VA's mission by supplying common administrative services to both VA

and other Federal entities at competitive prices. Most of the Fund's customers are within VA; business from VA customers accounted for 68.55 percent of FY 2004 revenue. VHA is the largest customer for the following VA Enterprise Centers: Austin Automation Center, Financial Services Center, Law Enforcement Training Center, Security and Investigations Center and VA Records Center and Vault. VBA is the largest customer for the Debt Management Center.

The Fund accounts for its funds in six lines of business (VA Enterprise Centers) and one administrative organization. A brief description of each center is listed below:

**Austin Automation Center (AAC)** - Located in Austin, Texas, the AAC provides comprehensive e-government solutions to match the critical needs of VA and other Federal agency customers, from managing data to automating business processes. The AAC supports over 100 customer applications that provide mission-critical data for financial management, payroll, human resources, logistics, medical records, eligibility benefits, and supply functions. In addition, the AAC offers a full complement of technical solutions (information technology system hosting, application management, information assurance, customer business continuity, configuration management, data conversion and data interfacing, and acquisition services) to best meet customers' varied project needs.

**Debt Management Center (DMC)** - Located in St. Paul, Minnesota, the DMC is a centralized facility that provides direct collection of delinquent consumer debt owed to VA. The DMC also provides administrative support for a local Cooperative Administrative Support Unit.

**Financial Services Center (FSC)** - Located in Austin, Texas, the FSC provides VA and other government agencies with a full range of financial services, which include financial reports, accounting, invoice payments, credit card payments, medical claims payments, vendor file maintenance, discount subsistence purchases, payroll processing, travel payment processing, electronic commerce/electronic data interchange, automated document management, audit recovery, data matching and reconciliation, and consulting.

**Law Enforcement Training Center (LETC)** - Located in Little Rock, Arkansas, the LETC provides special training for police officers working in a health care or service-oriented environment. Emphasizing training in medical center patient situations, the LETC is available to approximately 2,400 law enforcement personnel working

at VHA health care facilities and to Federal law enforcement professionals at other Federal agencies.

**VA Records Center and Vault (VA RC&V)** - Located in a subterranean, climate-controlled, secure facility in the Midwest, the VA RC&V provides records storage, protection, and retrieval services for official Federal records. The facility has been certified by the National Archives and Records Administration to operate as an agency records center. The VA RC&V can store records in any type of medium. This includes off-site storage of systems backups, as well as general, vital, and classified records on paper, film, and electronic media.

**Security and Investigations Center (SIC)** - Located in Washington, DC, the SIC provides quality and timely background investigations and adjudications for employees and contractors in sensitive positions for all VA entities nationwide. The SIC also issues and manages employee identification badges and provides fingerprint processing for VA employees and other Federal customers in the Washington, DC area.

**Enterprise Fund Office (EFO)** - The VA Enterprise Centers are supported by the EFO, which is responsible for overall fund operations including administering the financial resources of the Fund, coordinating all business activities, and serving as the liaison between the Enterprise Centers, their customers, and the Franchise Fund Board of Directors.

The Enterprise Fund allows VA and other government agency customers to conserve their budgetary resources through new innovative methods and/or efficiencies of scale with the same or lower unit costs, while improving the quality of services provided. As the Fund successfully expands its services to other Federal agencies, those agencies will derive similar benefits.

For more information, visit the VA Enterprise Centers online at [www.va.gov/fund](http://www.va.gov/fund).

### 3. Supply Fund Services

Supply Fund functions include contracting for medical supplies, equipment, and services; stocking, repairing, and distributing supplies, medical equipment, and devices; providing forms, publications, and a full range of printing and reproduction services; training VA medical acquisition, supply, processing, and distribution

personnel; and increasing small and disadvantaged business participation in VA contracts. The two largest customers for the Supply Fund are VA and DoD, but the Fund also has significant sales to other Federal agencies including the Department of Health and Human Services.

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